No. 12879

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

James Monroe Jefferson,

Appellant,

vs.

Stockholders Publishing Co., Inc., a Nevada corporation,

Appellee.

APPELLANT'S OPENING BRIEF.

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APPELLANT'S OPENING BRIEF.

A.
Statement of the Pleadings and Facts Disclosing Jurisdiction.

Appellant is a resident of California and appellee is a Nevada corporation. The matter in controversy exceeds the sum of $3000 [R. 3]. The action is predicated on an alleged libel in a newspaper, and the District Court has jurisdiction because of the diversity of citizenship and the amount in controversy as provided in 28 U. S. C. 1332. A final order of dismissal was entered [R. 14] and this court has jurisdiction of an appeal therefrom as provided in 28 U. S. C. 1291.

B.

Statement of the Case.

Appellant filed his complaint in the District Court of the Southern District of California asking $100,000 damages because of a libel published in the "Daily News," a newspaper owned and published by appellee [R. 3 to 9]. The complaint was filed January 12, 1950 [R. 9]. A summons was not issued at that time as a bond was not filed [R. 19].

Thereafter, on August 22, 1950, an undertaking on suit for libel in the amount of $500 was filed and summons issued [R. 19]. The summons was served and it was then filed in court August 30, 1950 [R. 12].

A motion to dismiss was filed on September 13, 1950 [R. 19]. An amended motion to dismiss was thereafter filed on September 28, 1950 [R. 13], which amended motion was granted and the action ordered dismissed [R. 15] on the ground that appellant failed to comply with Rule 4(a) F. R. C. P. in that the complaint was filed on the 12th day of January, 1950, and the summons was not issued until the 22nd day of August, 1950, over seven months' later [R. 15]. Rule 4(a) provides as follows:

> "4(a) Summons: Issuance. Upon the filing of the complaint the clerk shall forthwith issue a summons and deliver it for service to the marshal or to a person specially appointed to serve it. Upon request of the plaintiff separate or additional summons shall issue against any defendants."

The trial court concluded that because of such delay in issuance of summons, the action should be dismissed under Rule 41(b) F. R. C. P. [R. 15]. Rule 41(b) provides that a defendant may move for dismissal for failure of the plaintiff to comply with the rules.

As disclosed on the clerk's docket entries, summons was not issued when the complaint was filed because a bond was not then on file [R. 19]. The bond was filed August 22, 1950, and the summons was issued forthwith on the same day as shown in the docket entries [R. 19].

The federal court has jurisdiction only because of diversity of citizenship, as the action is for libel under the law of California and that law governs as to the rights of the parties. One of the rights accorded the defendant in a libel action is that a bond shall be furnished by plaintiff before summons can be issued by the clerk (Act 4317 General Laws of California, p. 1532). Section 1 of that act is as follows:

> §1. Undertaking. In an action for libel or slander the clerk shall, before issuing the summons therein, require a written undertaking on the part of the plaintiff in the sum of five hundred (500) dollars, with at least two competent and sufficient sureties, specifying their occupations and residences, to the effect that if the action be dismissed or the defendant recover judgment, that they will pay such costs and charges as may be awarded against the plaintiff by judgment or in the progress of the action, or on an appeal, not exceeding the sum specified in the undertaking. An action brought without filing the undertaking required shall be dismissed."

After providing for justification of sureties, exceptions, new bonds, etc., the same act provides in Section 7 as follows:

> "§7. Costs. In case plaintiff recovers judgment, he shall be allowed as costs one hundred (100) dollars, to cover counsel fees, in addition to the other costs. In case the action is dismissed, or the defendant recover judgment, he shall be allowed one hundred (100) dollars, to cover counsel fees, in addition to the other costs, and judgment therefor shall be entered accordingly."

It will be noted that Section 1 does not require the filing of the bond before the filing of the complaint or concurrently therewith, but is addressed only to the issuance of the summons. The California Code of Civil Procedure provides an action is commenced with the filing of the complaint as follows:

> "§ 350. When an action is commenced. An action is commenced, within the meaning of this title, when the complaint is filed. (Enacted 1872.)"

That California Code also provides that the filing of the complaint is the commencement of the action as follows:

> "§ 405. (Actions, how commenced.) Civil actions in the courts of this state are commenced by filing a complaint. (Enacted 1872; Am. Code Amdts. 1873-74, p. 296.)"

Under the California law summons can be issued at any time within one year after the complaint is filed as provided in the Code of Civil Procedure as follows:

> "§ 406. (Indorsement of complaint: Summons, issuance and service.) The clerk, or, if there be no clerk, the justice, must indorse on the complaint the

day, month and year that it is filed, and at any time within one year thereafter the plaintiff may have a summons issued, * * *"

The questions involved on this appeal all grow out of a determination whether the requirement of F. R. C. P. that a summons be issued "forthwith" after the filing of the complaint is mandatory, and means immediate, as against the California law that the summons may be issued any time within one year after the filing of a complaint and the requirement of the California law that the summons cannot be issued in a libel action until a bond is filed for the protection of the defendant.

C.

Specification of Errors.

Appellant relies upon the following specification of errors:

1. The court erred in finding that the appellant failed to comply with Rule 4(a) of F. R. C. P. in the delay in the issuance of summons.

2. The court erred in refusing to recognize the provision of the state law that summons may be issued within one year after the complaint is filed when it recognized that the summons cannot be issued until an undertaking was filed as required by state law and that the appellee was entitled to a judgment for attorney's fees as provided in said state law.

3. The court erred in determining that the action should be dismissed because of the failure to have summons issued at the time of the filing of the complaint.

4. The court erred in finding that the court has no jurisdiction over the appellee, it having been served with summons and having appeared in the action.

D.
ARGUMENT.

Summary.

The federal rule that the clerk shall issue a summons "forthwith" on the filing of the complaint is not so rigid and inflexible as to prevent the application of state law in diversity of citizenship cases where conditions and privileges are established which affect the issuance of the summons.

The state law which requires the filing of a bond before the issuance of summons in a libel action is to be given effect by the federal court in a diversity of citizenship case. A state law which gives the plaintiff the privilege of filing such bond and having summons issued at any time within one year is also to be given effect by the federal court.

Diversity of citizenship cases are to be so conducted in federal courts that the results will be the same as if the case were in the state courts, in so far as legal rules affect the outcome.

Federal Rules.

Rule 4(a) F. R. C. P. provides that upon the filing of the complaint the "clerk" shall "forthwith" issue a summons. The duty and responsibility is placed on the clerk. No specific time requirement is fixed but only a duty which should be performed when the complaint has been filed and nothing is to be done except the clerk's actual issuance of the document itself.

The same section then provides that "upon request of the plaintiff" separate or additional summons shall issue. This sentence makes clear that there is no time limitation as such, but that a summons may be issued at a later

time when conditions warrant. In such a case, the clerk has no duty to issue the summons until the plaintiff requests it.

In neither sentence, read separately or together, is there any suggestion of a time deadline and that the failure of the clerk to actually issue the summons within a certain specified time would make it impossible for him to do so at a later date.

It was error for the district court to rule that the requirement that summons be issued forthwith is so rigid and inflexible that it cannot be varied, in a diversity of citizenship case, by a right or privilege granted by the state law.

California Law.

The California law does not put the responsibility on the clerk, but leaves it to the plaintiff to have summons issued and gives him one year within which to do so (Code of Civ. Proc., Sec. 406).

The state law also requires, in a libel suit such as the one now before the court, that the summons may not be issued until a bond has been filed for the protection of the defendant. Again the responsibility is on the plaintiff.

Since the plaintiff has the responsibility, the California law recognizes that there must be a time limit within which he may have the summons issued, and it fixed that period as one year after the filing of the complaint (Code of Civ. Proc., Sec. 406). This gives plaintiff one year within which to file the bond in a libel action.

The period of limitation for the commencement of actions in California (Code of Civ. Proc., Sec. 335) for libel is one year (Code of Civ. Proc., Sec. 340(3)). An

action is commenced when the complaint is filed (Code of Civ. Proc., Sec. 350).

The plaintiff thus has one year in which to file his complaint and an additional year within which he can make arrangements for and file his bond and have summons issued. The effect of the one year within which to file the bond is an extension of the statute of limitations for the purpose of the bond.

It was error for the district court to hold that the privileges, granted to the plaintiff by the state law, are all lost to him when he is in the federal court.

Diversity of Citizenship Case.

This case is in federal court only because of the diversity of citizenship of the parties. All rights are established by the state law. In the determination of the rights of the parties in the federal court, it is not necessary to conclude whether any particular point involves a substantive right or a procedural right, for the U. S. Supreme Court has established a very definite rule that "in all cases where a federal court is exercising jurisdiction solely because of the diversity of citizenship of the parties, the outcome of litigation in the federal courts should be substantially the same, so far as legal rules determine the outcome of a litigation, as it would be if tried in a state court." This quotation is from the case of

> *Guaranty Trust Co. v. York,* 326 U. S. 99, 65 S. Ct. 1464, 89 L. Ed. 2079.

See also:

> *Erie R. Co. v. Tompkins,* 304 U. S. 64, 58 S. Ct. 817, 82 L. Ed. 1188;
>
> *Regan v. Merchants Transfer Co.,* 69 S. Ct. 1233, 337 U. S. 530, 48 Mich. L. Rev. 531;
>
> *Isaacks v. Jeffers,* 144 F. 2d 26, Cert. Den. 323 U. S. 781, 89 L. Ed. 624, 65 S. Ct. 270.

Plaintiff Should Have Privileges as Well as Responsibilities Created by State Law.

In the case now before the court, the state law was applied as to the liabilities placed on plaintiff. The clerk would not issue summons because of the plaintiff's failure to file the bond and only did so after the bond was filed [R. 19]. The judgment recognizes the correctness of the clerk's action for the defendant is awarded $100 attorney's fees by virtue of the same state law which required the filing of the bond.

The court, however, refused to recognize the privilege, granted by the state law, of one year within which the plaintiff could file the bond after the filing of the complaint. Because the bond was not filed immediately and the clerk did not issue the summons "forthwith" the plaintiff was thrown out of court. This was without any recourse or opportunity for a day in court for the statute of limitations had run.

This outcome is the direct result of a strict construction and application of legal rules, is not on the merits, and is not the same result that would have been the outcome in the state court. It is directly contrary to the rule and policy established by the Supreme Court.

Furthermore, if it were possible to estop a court in the conduct of its affairs, the court's action in this case should bring about such a result. When the district court required the plaintiff to file a bond before summons would be issued, and when it gave defendant judgment for attorney's fees under the authority of the law which required the bond, that court should be estopped from denying him one year within which to file the bond as allowed under the state law.

The district court erred when it determined that the action should be dismissed because the summons was not issued at the time the complaint was filed. This result could only be brought about by a strict application of a legal rule of procedure and is one that cannot be justified in any manner under the state law.

The District Court Had Jurisdiction of Appellee.

Summons was issued and served on the appellee who made a general appearance in the action. There was no motion to quash the summons or the service. Appellee could have appeared without summons. Having appeared, it is too late for it to take advantage of the technicality as to the time when the summons was issued.

The court erred in ruling that it had no jurisdiction over appellee.

Conclusion.

Appellee should not be denied his day in court by a strict application of a federal rule which results in denying him privileges granted by the state law. This is particularly so when, as in this case, the alleged noncompliance with the federal rule was brought about by the federal court demanding compliance with a liability created by the state law. The judgment should be reversed.

Respectfully submitted,

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APPELLEE'S REPLY BRIEF.

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APPELLEE'S REPLY BRIEF.

A.

Statement of the Pleadings and Facts Disclosing Jurisdiction.

Appellant is a resident of the State of California and Appellee is a Nevada corporation. The matter in controversy is based on an action for damages for alleged libel wherein a sum in excess of $3,000 is sought [R. p. 3]. The United States District Court is alleged to have jurisdiction because of the diversity of citizenship and because of the amount in controversy as provided in 28 U. S. C. 1332. A final Order of Dismissal was entered [R. pp. 14-16] and this Court has jurisdiction of an appeal therefrom as provided in 28 U. S. C. 1291.

B.

Statement of the Case.

Appellant filed an action for damages for libel against the Appellee, alleged to have been suffered by reason of an article published in the "Daily News," a newspaper owned and published by Appellee [R. pp. 3-9]. The complaint was filed January 12, 1950 [R. p. 19]. The summons was not issued until August 22, 1950, over seven (7) months later [R. p. 19]. Thereafter Summons was served and filed with the Clerk on August 30, 1950 [R. p. 12].

An Amended Motion to Dismiss (the action) was filed by Appellee on September 28, 1950, under Rule 41b and Rule 12b, Clauses 2 and 4, of the Federal Rules of Civil Procedure [R. p. 13]. After consideration of Points and Authorities submitted by the parties and after oral argument, the Trial Court granted the Motion and ordered the action dismissed on January 15, 1951 [R. pp. 14-16].

Rule 41b provides as follows:

> "(b) Involuntary Dismissal: Effect Thereof. For failure of the plaintiff . . . to comply with these rules . . . a defendant may move for dismissal of an action or of any claim against him . . ."

Rule 12b, Clauses 2 and 4 provide as follows:

> "Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim, or third-party claim, shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion: . . .
>
> (2) Lack of jurisdiction over the person . . .

(4) Insufficiency of process . . .

. . . No defense or objection is waived by being joined with one or more other defenses or objections in a responsive pleading or motion . . ."

The Order of Dismissal recites two grounds therefor, to-wit:

"I.

That plaintiff failed to comply with Rule 4a of the Federal Rules of Civil Procedure, in that the complaint was filed on the 12th day of January, 1950, and the summons was not issued until the 22nd day of August, 1950, over seven (7) months later, and therefore, said action should be dismissed under Rule 41b of Federal Rules of Civil Procedure, and

II.

That plaintiff having failed to comply with Rule 4a of the Federal Rules of Civil Procedure as aforesaid, this Court, therefore, has no jurisdiction over the defendant."

There are only two questions presented by this Appeal, to-wit:

1. Did the court abuse its discretion in granting Appellee's Motion to Dismiss on the ground that Appellant failed to comply with the federal rules of Civil Procedure;

2. Did the court err in ruling that it has no jurisdiction under the above statement of facts, over the Appellee.

If the Court determines that either of the foregoing questions should be answered in the negative, the Order of Dismissal must be affirmed.

C.

ARGUMENT.

Summary.

The record here clearly shows that Appellant did not comply with the provisions of Rule 4a of the Federal Rules of Civil Procedure. In such circumstances the Court may, in the exercise of its discretion, dismiss the action.

The United States Supreme Court promulgated the Federal Rules of Civil Procedure. These Rules may not be superseded by State Rules of Civil Procedure in United States District Courts.

The United States District Court had no jurisdiction over the Appellee for the reason that the action was not commenced in accordance with the requirements of Rules 3 and 4a of the Federal Rules of Civil Procedure, in that the Summons was not issued until over seven months after the date of the filing of the complaint.

Appellee by appearing by a Motion to Dismiss, which Motion attacks the jurisdiction of the Court, does not, by such appearance, confer jurisdiction upon the Court, the distinction between general and special appearances having been abolished.

I.

The Court Did Not Abuse Its Discretion in Dismissing the Action Under Rule 41b of the Federal Rules of Civil Procedure.

The Summons was not issued in accordance with the provisions of Rule 4a, Federal Rules of Civil Procedure, and, therefore, it was proper for the Court to dismiss the action under Rule 41b, Federal Rules of Civil Procedure. Rule 4a provides:

> "Upon the filing of the complaint the Clerk *shall forthwith* issue a summons and deliver it for service to the marshal or to a person specifically appointed to serve it . . ." (Emphasis supplied.)

Rule 41b, Federal Rules of Civil Procedure (*supra*), provides that the Court, in its discretion, may dismiss an action for failure to comply with the Rules.

In the case at bar no summons was issued until over seven months after the complaint was filed. Appellant now attempts to excuse himself for his failure to comply with the requirements of Rule 4a on the ground that he was required to file an Undertaking under the provisions of the California law. The pertinent provisions of the California law to which Appellant has reference is found in Section 4317, General Laws of California, page 1532. Section 1 provides:

> "1. Undertaking. In an action for libel or slander the clerk shall, *before issuing the summons therein,* require a written undertaking on the part of the plaintiff in the sum of five hundred (500) dollars, with at least two competent and sufficient sureties, specifying their occupations and residences, to the effect that if the action be dismissed or the defendant

> recover judgment, that they will pay such costs and charges as may be awarded against the plaintiff by judgment or in the progress of the action or on an appeal, not exceeding the sum specified in the undertaking. An action brought without filing the undertaking required shall be dismissed." (Emphasis supplied.)

It is to be noted that the provisions of the California law requiring an Undertaking in a libel action provide that the Clerk of the Court must require an Undertaking *"before issuing the Summons."*

It is also to be noted that a plaintiff in a libel action (whether in the State Court or the Federal Court) does not have *one year* within which time to file an Undertaking as suggested by Appellant (App. Op. Br. pp. 7, 8, 9). *Per contra,* the Undertaking must be filed *before issuing the summons.*

Appellant argues (App. Op. Br. pp. 7, 8) that since he was required to file an Undertaking under the provisions of the California law (clearly a Statute involving *substantive* law) that the United States District Court should, thenceforth, be governed not by the Federal Rules of Civil Procedure but by the California Code of Civil Procedure, Section 406, which permits plaintiff to request issuance of a Summons any time within one year from the date of the filing of the complaint.

Appellant's position obviously is fallacious. Appellant chose the United States District Court as his Forum. That Court requires that Summons be issued "forthwith" upon the filing of the complaint. The plaintiff in a libel action, therefore, must provide the Undertaking at the time of the filing of the complaint, to the end that the Clerk can issue the Summons "forthwith," thereby complying

with the provisions of Rule 4a. Plaintiff having thus chosen his Forum, it follows as of course, that he must abide by the *procedural* rules of such Forum.

See *Merchants Transfer Co. v. Regan,* 170 F. 2d 987 (1948), where the Court said at page 991:

> "It is quite well settled that the manner and method to be followed in commencing actions is procedural and is controlled by the laws of the forum in which the action is filed."

and at page 992:

> ". . . We held that the time within which the action must be brought or filed . . . was controlled by New Mexico law, *but that the manner in which it was brought or filed was procedural and in the Federal Court was controlled by its rules of procedure* . . ." (Emphasis supplied.)

See *Isaacks v. Jeffers,* 144 F. 2d 26 (1944), Cert. Den. 326 U. S. 781, 65 S. Ct. 270 (also cited by Appellant), where the Court stated at page 28:

> ". . . the *manner* in which actions are commenced, when actions are deemed to have begun, the manner and method of serving process all relate to *procedure* and *are governed by the law of the forum in which the action* is instituted . . ." (Emphasis supplied.)

See also *Yudin v. Carroll,* 57 Fed. Supp. 793 (1944), where the Court said at pages 798 and 799:

> ". . . Rule 3 provides that the first step in an action is the filing of a complaint. That step is to be followed *forthwith* by issuance of a summons and its delivery for service to the Marshal . . . The requirement of Rule 4a that the summons be delivered

for service to the Marshal serves a salutary purpose. Unless both provisions are read and considered together *substantive rights of persons may be seriously affected without their knowledge that a complaint has been filed* in the office of the clerk . . ." (Emphasis supplied.)

See also *Schram v. Holmes,* 4 F. R. D. 119 (1943). In this case the process service was made nine months after the complaint was filed (although the summons was issued forthwith) and six months after the Statute of Limitations had run. The Court held that there was a lack of diligence and the case was thereupon dismissed.

The Court said, at page 122:

"It is our conclusion that this court has the power to determine whether or not there has been due diligence used and we hold that in this particular action there was not. Nine months may not usually be of great importance in the life of a country or a world. On the other hand much can happen within that limited period. If the defendant had been served when he should have been served he might have made a settlement. It might have stopped interest running. He might have been in a position to offer a defense which he hasn't got now. Plaintiff knew for the greater part of six years that he was going to bring action against defendant some day if defendant didn't pay, but he held back almost the entire six years and then added six months more to the statute of limitations. In the meantime between the time of the filing the bill of complaint and serving of the summons, great events rocked the world. In fact, it was in this interim that the second world war was started. Not that this necessarily had any disastrous effect upon defendant, but it may serve as

illustrative of one reason why due diligence should be required at all times in the service of process. There are rapid changes of events nowadays that affect almost every individual. Home Savings Bank v. Young, 295 Mich. 725, 295 N. W. 474."

In the case at bar the summons was not even *issued* until over seven months after the complaint was filed and process service was not made until approximately seven months after the Statute of Limitations had run.

The alleged libelous article was published in the Daily News under date of January 19, 1949 [R. p. 4], and the Complaint was filed in the United States District Court on January 12, 1950 [R. p. 19], one week prior to the bar of the Statute of Limitations.

Summons was not issued nor served until after August 22, 1950 [R. p. 19]; a period of more than seven months after the action had been barred by the California Statute of Limitations. The Statute of Limitations on libel actions in the State of California is one year (California Code of Civil Procedure, Subdivision 3 of Section 340).

Thus the record clearly shows that the Appellant negligently allowed over seven months to elapse beyond the Statute of Limitations before he even procured the issuance of the Summons. Thus there was no commencement of the action which would toll the Statute.

It is stated in Barron & Holtzoff Federal Practice and Procedure, Rules Edition, Vol. 1, at page 276, as follows:

"The Commentators agree, however, that although the Statute of Limitations may be regarded as a substantive matter, the method by which an action is commenced so as to toll the Statute is a question of procedure which is governed by Rule 3. The Courts

> have almost universally adopted this view, stating that the filing of the complaint under Rule 3 commences the action within the meaning of Statutes of Limitations. *This statement is subject to the qualification that delay in three additional steps, issuance of summons, delay to an officer for service, and service of summons and complaint on defendant may nullify the effect of filing the complaint."* (Emphasis supplied.)

It is to be noted that the Appellant in the instant case, delayed in *all three* of the steps above noted, *i. e.,* he delayed over seven months in the issuance of the summons; he delayed over seven months in delivering the same to an officer for service; and there was a delay of over seven months in serving the summons and complaint on the defendant. The corporate defendant, publisher of a large metropolitan newspaper, could have been readily served at any time.

See also, 8 Brooklyn Law Review 188, at page 193, where it is stated:

> "It would seem, however, that the filing of the complaint conditionally suspends the running of the Statute of Limitations, provided *the summons is issued forthwith and served within a reasonable time thereafter."*

Appellant having failed for over seven months to procure the issuance of the summons, did not comply with the clear unequivocal requirements of Rule 4a of the Federal Rules of Civil Procedure and by failing to deliver the summons and complaint to the Marshal for service, and by failing to cause service of summons and complaint to be made upon the defendant for such period, he certainly did not proceed with diligence.

Appellant argues (App. Op. Br. pp. 6, 7), that the word "forthwith" should be given a broad meaning, stating that "no specific time requirement is fixed" (when the United States District Court Clerk shall issue a summons).

We respectfully submit that the word "forthwith" does fix a specific time.

Black's Law Dictionary, Third Edition, defines "forthwith" as follows:

> "As soon as, by reasonable exertion, confined to the object, a thing may be done. Thus, when a defendant is ordered to plead forthwith, he must plead within twenty-four hours . . ."

Webster's New Twentieth Century Dictionary Unabridged, defines "forthwith" as follows:

> "1. Immediately; without delay; directly.
>
> 2. In law, as soon as the thing required may reasonably be done, commonly within twenty-four hours."

In light of these definitions, and the commonly understood meaning of the word, we are unable to follow Appellant's argument that "no specific time requirement is fixed."

Appellant also argues (App. Op. Br. pp. 6, 7), that the Rule (Rule 4a) makes clear that there is no time limitation as such because the Rule further "provides that 'upon request of the plaintiff' separate or additional summons shall issue."

It is implicit in the very language used that such authority granted to the Clerk contemplates the original issuance *forthwith* of a summons. The language referred to by

Appellant obviously refers to an *additional* or *alias* summons. We respectfully submit that this language is complementary to the first sentence, and in fact, accentuates the mandatory provision therein contained, *i. e.,* that the Clerk shall issue the summons forthwith upon the filing of the complaint.

We submit that the Court could not do otherwise than dismiss the case at bar in the circumstances and in light of the facts disclosed by the record. For the Trial Court to set a precedent to the effect that a Summons may be issued, in direct conflict with the Federal Rules of Civil Procedure, over seven months after the filing of the complaint, would be a dangerous precedent, and would effectively break down and render a nullity the pertinent provisions of the Federal Rules of Civil Procedure.

Following Appellant's reasoning, a District Court of the United States would be required to be governed by the myriad State Laws of Civil Procedure when a State Statute with reference to *substantive* law was to be interpreted. The Federal Rules of Civil Procedure in these circumstances would have little or no meaning and in fact, to pursue Appellant's argument to its logical conclusion, there would be little or no necessity for Federal Rules of Civil Procedure and Rule 4a would be a nullity. Appellant would have the United States District Courts bound by State Procedural rules rather than the Federal Rules of Civil Procedure promulgated by the Supreme Court of the United States, solely by reason of the fact that a State Statute involving *substantive* rights was involved.

II.

The Court Has No Jurisdiction Over the Defendant for the Reason That the Summons Was Not Issued Pursuant to Rule 4a of the Federal Rules of Civil Procedure, and Thus There Has Been an Insufficiency of Process Under Said Rule and, Therefore, There Has Been No Commencement of the Action.

Rule 3 of the Federal Rules of Civil Procedure provides:

> "A civil action is commenced by the filing of a complaint with the Court."

As hereinabove quoted, Rule 4a of the Federal Rules of Civil Procedure provides that upon the filing of the Complaint the Clerk shall "forthwith" issue a summons. In commenting upon this phase of the matter, it is stated in *Isuacks v. Jeffers, supra,* at page 28:

> "We are of the opinion that since the adoption of the Federal Rules of Civil Procedure, we must now look to Rules 3 *and* 4 to determine *when the action is commenced.*" (Emphasis supplied.)

Historical Background to Present Rules 3 and 4a, Federal Rules of Civil Procedure:

In exploring the basic *reasons* for the present rules 3 and 4a, it is important to note that in hearings which were held before the House Judiciary Committee, when the present rules were being formulated, it was stated:

> "There are at least six different views in the various states as to what constitutes the commencement of an action. That means great confusion when you

> come into the Federal Court. Does the filing of the complaint commence the action or is it the issuance of the summons . . . or is it the actual service of it? . . . Therefore, to avoid this confusion, Rule 3 fixes the filing of the complaint as the point of time which constitutes the beginning of an action. Rule 4a provides for the *immediate automatic issuance* of the summons and its delivery by the Clerk to the Marshal for service. Thus the steps which in various states have been taken as the beginning of the action must follow in quick sequence." (Emphasis supplied.)

See Edgar B. Tolman, Hearings Before the House Judiciary Committee, March 1-4, 1938, page 73.

Another important point in examining the historical background leading up to the adoption of the present Federal Rules of Civil Procedure is that the Federal Courts, prior to the adoption of these Rules, usually required, not only the filing of a complaint, but also the issuance of summons and delivery of process to the Marshal for service as a prerequisite for full commencement of the suit.

See *Andis v. Schick Dry Shaver, Inc.*, 94 F. 2d 271 (1938), where the Court stated that an action is deemed commenced so far as the parties to it are concerned, from the time the process is issued, and delivered to the serving officer with a bona fide intent to be served.

See also, *Farmers Loan & Trust Co. v. Lake Street Elevated R. R. Co.*, 177 U. S. 51; 20 Supreme Court 564

(1900), where the Court stated at 20 Supreme Court, page 568:

> "As between the immediate parties in a proceeding . . . jurisdiction must be regarded as attaching when the bill is filed and process has issued and where . . . the process is subsequently duly served . . ."

In analyzing the foregoing excerpts from the cases decided prior to the adoption of Federal Rules of Civil Procedure and the legislative history preceding the adoption of the rules, it is clear that the draftsmen of the Rules intended to require that an action be commenced by the filing of a complaint and the issuance of the summons *forthwith* to obviate the former confusion which had existed.

III.

The Trial Court Did Not Abuse Its Discretion in Dismissing the Action.

A Trial Court is vested under the Federal Rules of Civil Procedure (41b) with the power to dismiss an action for various causes, including laches or lack of diligence on the part of the plaintiff in prosecuting the action; failure to comply with any Order of Court or failure to comply with the Federal Rules of Civil Procedure. This power is addressed to the sound discretion of the Trial Court, and the exercise of such discretion should not be disturbed except upon a clear showing of an abuse of such discretion. This principle is basic and well established.

See *Shotkin v. Westinghouse Electric and Manufacturing Co.,* 169 F. 2d 825 (1948), where the Court said at page 826:

> "A motion to dismiss for failure to prosecute diligently is addressed to the sound judicial discretion of the Court, and the action thereon will not be disturbed on appeal unless such discretion was abused . . ."

See also, *Sweeney v. Anderson,* 129 F. 2d 756 (1942), where the Court said, at page 758:

> ". . . Every Court has the inherent power in the exercise of a sound judicial discretion, to dismiss a cause for want of prosecution. The duty rests upon the plaintiff to use diligence and to expedite his case to a final determination. The decision of a Trial Court in dismissing a cause for lack of prosecution will not be disturbed on appeal unless it is made to appear that there has been a gross abuse of discretion."

It should be noted here that the Appellant does not complain that the Trial Court abused its discretion, Appellant contending, *per contra,* that the Court committed an error of law. We respectfully submit that the record shows that no error of law was committed. The record likewise shows that the Appellant flagrantly disregarded the Federal Rules of Civil Procedure. The Trial Court, in the exercise of its sound judicial discretion, dismissed the action under the provisions of 41b, *supra.* Certainly, as above stated, in the light of the foregoing facts, it would

have been a dangerous procedent for the Trial Court to set, by ruling, in effect, that the Rules of Civil Procedure of the State of California take precedence over the Federal Rules of Civil Procedure in the United States District Court.

IV.

Appellant Has Not Correctly Construed the So-called "Outcome of Litigation Rule" in Diversity of Citizenship Cases.

Appellant contends that inasmuch as this case is before the Federal Court solely by reason of the diversity of citizenship of the parties, that the Court should apply the rule laid down in *Guaranty Trust Company v. York,* 326 U. S. 99, 65 Sup. Ct. 1464, and *Regan v. Merchants Transfer Co.,* 337 U. S. 530, 69 Sup. Ct. 1233, to the effect that the outcome of litigation in the Federal Courts should be substantially the same so far as legal rules determine the outcome of litigation, as it would have been if tried in a State Court. These two cases both involved the application of a State Statute of Limitations, and hold that the Federal Court must apply the State Law with reference to the time and manner in which the Statute of Limitations is tolled under the State Law. Clearly, these cases are not analogous in any way to the case at bar wherein Appellant contends that a United States District Court must apply the *California Rules of Civil Procedure* in lieu of the *Federal Rules of Civil Procedure.*

V.

Under the Federal Rules of Civil Procedure, Jurisdiction of the Court Properly May Be Attacked by a Motion to Dismiss.

Appellant contends (App. Op. Br. p. 10) that Appellee by appearing by Motion to Dismiss, has made a "general appearance" and that, therefore, the Court has jurisdiction over Appellee. Appellant also suggests that the proper procedure would have been to appear by a "Motion to Quash the Summons or the Service."

Appellee appeared by a Motion to Dismiss [R. p. 13] under Rule 12b of the Federal Rules of Civil Procedure. Such appearance, when made for the purpose of attacking the Court's jurisdiction, does not constitute a "general appearance" which would confer jurisdiction upon the Court.

See *Orange Theatre Corp. v. Rayherstz Amusement Corp.,* 139 F. 2d 871 (1944) (certiorari denied by United States Supreme Court, 322 U. S. 740, 64 S. Ct. 1057), where it is stated, at page 874:

> "It necessarily follows that Rule 12 has abolished for the Federal Courts, the age-old distinctions between general and special appearances. A defendant need no longer appear specially to attack the Court's jurisdiction over him . . ."

Conclusions.

In Appellant's Specification of Errors (App. Op. Br. p. 5) Appellant specifies

> 1. "1. The Court erred in finding that the appellant failed to comply with Rule 4(a) of F. R. C. P. in the delay in the issuance of summons." and . . .
>
> "3. The court erred in determining that the action should be dismissed because of the failure to have summons issued at the time of the filing of the complaint."

The record shows that the Appellant did fail to comply with such rule, *i. e.,* the rule requires that a summons be issued "forthwith" and the summons in this case was not issued until over seven months after the filing of the complaint. There is no provision in Rule 4a that this time may be extended for *any* reason or cause, and *per contra,* the rule is *mandatory* in its requirements that the summons be issued forthwith.

The rule has solid historical background and is supported by sound reasons. Such rule can be enforced, by the exercise of the sound discretion of the Trial Court, only by the action taken by the Trial Court in the instant case.

2. Appellant's second specification of error is to the effect that the Court erred in refusing to apply the provisions of the California Rules of Civil Procedure which permits the Clerk to issue a summons within one year from the date of the filing of the complaint. Appellant

has made no showing that the Federal Court is required to follow the California Rules of Civil Procedure merely because the Federal Court recognizes a substantive statute of this State.

3. Appellant's fourth specification is to the effect that the Court erred in finding that it had no jurisdiction over the Appellee, it having been served with summons and having appeared in the action by its Motion to Dismiss.

We have clearly shown that a defendant may appear by Motion to Dismiss and attack the jurisdiction of the Court under the appropriate provisions of the Federal Rules of Civil Procedure, Section 12b, and that such appearance does not thereupon confer jurisdiction upon the Court.

It is respectfully submitted:

1. That the Court did not abuse its discretion by dismissing the within action by reason of the failure of Appellant to comply with the Federal Rules of Civil Procedure;

2. That no error of law was committed by the Court in finding that it had no jurisdiction over Appellee.

The Trial Court's Order of Dismissal should be affirmed.

Respectfully submitted,

Binford & Binford,
L. B. Binford,
Howard M. Binford,
Attorneys for Appellee.

No. 12,879

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

James Monroe Jefferson,

Appellant,

vs.

Stockholders Publishing Company, Inc., a corporation,

Appellee.

PETITION FOR REHEARING.

Binford & Binford,
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Howard M. Binford,
606 South Hill Street,
Los Angeles 14, California,
Attorneys for ~~Appellant.~~ Appellee

Parker & Company, Law Printers, Los Angeles. Phone MA. 6-9171.

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TABLE OF AUTHORITIES CITED

Cases

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Textbooks

No. 12,879

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

James Monroe Jefferson,

Appellant,

vs.

Stockholders Publishing Company, Inc., a corporation,

Appellee.

PETITION FOR REHEARING.

To the Honorable Judges of the United States Circuit Court of Appeals, for the Ninth Circuit:

Petitioner, Stockholders Publishing Company, Inc., a corporation, appellee herein, hereby respectfully petitions for a rehearing of the above entitled cause, wherein on the 18th day of January, 1952, this Honorable Court rendered its written opinion after submission of the cause on written briefs and after oral argument before the Honorable Clifton Mathews, Albert Lee Stephens and William E. Orr, Circuit Judges.

Grounds.

I.

THAT ACT 4317 OF DEERING'S GENERAL LAWS OF CALIFORNIA (REQUIRING PLAINTIFF TO FILE A BOND PRIOR TO THE ISSUANCE OF A SUMMONS IN ANY ACTION FOR LIBEL OR SLANDER) IS A SUBSTANTIVE LAW OF THE STATE OF CALIFORNIA AND IS NOT MERELY A PROCEDURAL LAW BUT ACCORDS TO A DEFENDANT IN CALIFORNIA CERTAIN SUBSTANTIVE RIGHTS IN ACTIONS OF SUCH CHARACTER.

II.

THAT UNDER THE DECISIONS OF THE UNITED STATES SUPREME COURT THE FEDERAL COURT MUST RECOGNIZE AND GIVE FULL EFFECT TO THE SUBSTANTIVE LAWS OF THE SEVERAL STATES, AND IN THE INSTANT CASE THE FEDERAL COURT, THEREFORE, IS REQUIRED FULLY TO RECOGNIZE THE PROVISIONS OF ACT 4317 OF DEERING'S GENERAL LAWS OF THE STATE OF CALIFORNIA.

III.

THAT THE "OUTCOME OF LITIGATION RULE" LAID DOWN BY THE UNITED STATES SUPREME COURT MUST BE APPLIED IN THE CASE AT BAR WHEREIN THE PARTIES ARE BEFORE THE FEDERAL COURT SOLELY BY REASON OF DIVERSITY OF CITIZENSHIP.

IV.

THAT THE FAILURE OF THE CLERK TO ISSUE SUMMONS FORTHWITH, AS REQUIRED BY RULE 4(a) OF THE FEDERAL RULES OF CIVIL PROCEDURE, WAS OCCASIONED SOLELY BY THE FAILURE OF THE APPELLANT TO FILE WITH THE CLERK AT THE TIME APPELLANT FILED HIS COMPLAINT, A BOND AS REQUIRED BY THE SUBSTANTIVE LAW OF THE STATE OF CALIFORNIA.

ARGUMENT ON GROUND I.

That Act 4317 of Deering's General Laws of California (Requiring Plaintiff to File a Bond Prior to the Issuance of a Summons in Any Action for Libel or Slander) Is a Substantive Law of the State of California and Is Not Merely a Procedural Law but Accords to a Defendant in California Certain Substantive Rights in Actions of Such Character.

Act 4317, Section 1, provides:

> "§1. Undertaking. In an action for libel or slander the clerk shall, before issuing the summons therein, require a written undertaking on the part of the plaintiff in the sum of five hundred (500) dollars, with at least two competent and sufficient sureties, specifying their occupations and residences, to the effect that if the action be dismissed or the defendant recover judgment, that they will pay such costs and charges as may be awarded against the plaintiff by judgment or in the progress of the action, or on an appeal, not exceeding the sum specified in the undertaking. An action brought without filing the undertaking required shall be dismissed."

The Act clearly establishes substantive law which accords to a defendant in a libel or slander action filed in California certain rights which assure the defendant that there will be funds available, in the event the defendant finally prevails in the litigation, with which to at least partially defray his costs and attorney's fees. That is to say: *He may not be summoned into court until the bond required by the California law is first deposited*

with the clerk of the court. However, in this Honorable Court's decision, the Court states as follows:

> "This being an action for libel and no undertaking for the payment of costs having been filed with the complaint, the clerk appears to have assumed that compliance with Rule 4(a) was precluded by §1 of Act 4317 of Deering's General Laws of California. The assumption was incorrect. *Section 1 relates to State court actions, not to Federal court actions.*" (Emphasis supplied.)

We respectfully submit that Section I of Act 4317, *supra,* is a law according *substantive* rights to all defendants in libel or slander actions in the State of California *regardless of the forum in which the action may be commenced.*

As was stated in *Appellant's Opening Brief* (p. 3):

> "The federal court has jurisdiction only because of diversity of citizenship, as the action is for libel under the law of California and that law governs as to the rights of the parties. *One of the rights accorded the defendant in a libel action is that a bond shall be furnished by plaintiff before summons can be issued by the clerk* (Act 4317 General Laws of California, p. 1532). Section 1 of that act is as follows: . . ." (Emphasis supplied.)

Thus, appellant himself concedes that the statute confers substantive rights upon a defendant and that a defendant is entitled to enjoy those rights in the United States District Court as well as in the state courts.

The distinctions between substantive and procedural laws are well established, both in text books and by Federal and State court decisions.

See *Black's Law Dictionary,* Third Edition, which gives the following definition:

> "Substantive Law: That part of the law which the courts are established to administer as opposed to the rules according to which the substantive law itself is administered. That part of the law which creates, defines and regulates rights, as opposed to adjective or remedial law, which prescribes the method of enforcing rights or obtaining redress for their invasion."

See *Cohen Executrix v. Beneficial Industrial Loan Corp.,* 337 U. S. 541; 69 Supreme Court 1221, 93 L. Ed. 1528 (1948), wherein the distinctions between procedural and substantive law are pointed out and discussed and wherein a state statute (New Jersey) analogous to Act 4317 of Deering's General Laws of the State of California was held to be a statute conferring substantive rights as distinguished from mere procedure.

See also *Shell Oil Co. v. Superior Court,* 2 Cal. App. 2d 348 (1934) where the Court stated at page 355:

> "The statute* requiring the filing of a bond for costs in a libel suit is to protect those who in good faith are exercising their Constitutional guaranty of free speech and freedom of the press against the too common practice of instituting libel and slander suits inspired by mere spite and ill will and without good faith."

Thus, we respectfully submit, it is abundantly clear that Act 4317 is a substantive law and creates substantive rights.

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*Act 4317 of Deering's General Laws of the State of California.

ARGUMENT ON GROUND II.

That Under the Decisions of the United States Supreme Court the Federal Court Must Recognize and Give Full Effect to the Substantive Laws of the Several States, and in the Instant Case the Federal Court, Therefore, Is Required Fully to Recognize the Provisions of Act 4317 of Deering's General Laws of the State of California.

The Rules of Decision Act (28 U. S. C. A., Sec. 1652) provides as follows:

> "The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States in cases where they apply."

Thus, Act 4317, Deering's General Laws of the State of California, being a substantive statute, must be followed in the Federal courts. Analogous statutes in other jurisdictions have been held by the United States Supreme Court to be applicable and binding upon the Federal courts.

See *Cohen Executrix v. Beneficial Industrial Loan Corp., supra,* wherein a State statute accorded corporations the right to require from a plaintiff security for reasonable expenses in any derivative action by a stockholder against the corporation, and wherein the Court stated at 337 U. S. at pages 555 and 556:

> "Even if we were to agree that the New Jersey statute is procedural, it would not determine that it is not applicable. Rules which lawyers call procedural do not always exhaust their effect by regu-

lating procedure. But this statute is not merely a regulation of procedure. With it or without it the main action takes the same course. However, *it creates a new liability* where none existed before, for it makes a stockholder who institutes a derivative action liable for the expense to which he puts the corporation and other defendants, if he does not make good his claims. Such liability is not usual and it goes beyond payment of what we know as 'costs.' If all the Act did was to create this liability, it would clearly be substantive. *But this new liability would be without meaning and value in many cases if it resulted in nothing but a judgment for expenses at or after the end of the case. Therefore, a procedure is prescribed by which the liability is insured by entitling the corporate defendant to a bond of indemnity before the outlay is incurred. We do not think a statute which so conditions the stockholder's action can be disregarded by the federal court as a mere procedural device.*" (Emphasis supplied.)

The analogy here is clear. Act 4317 creates a new liability where one did not previously exist. It prescribes a procedure by which the liability is insured prior to the time a defendant is required to expend money and entitles the defendant to a bond of indemnity prior to the time that he may be summoned into a court. These are substantive rights and are rights, we respectfully submit, which a defendant has in California whether he be before a State court or the United States District Court.

ARGUMENT ON GROUND III.

That the "Outcome of Litigation Rule" Laid Down by the United States Supreme Court Must Be Applied in the Case at Bar Wherein the Parties Are Before the Federal Court Solely by Reason of Diversity of Citizenship.

The case at bar is in the Federal courts solely by reason of diversity of citizenship. With reference to such class of cases the United States Supreme Court in the case of *Guarantee Trust Co. v. York,* 326 U. S. 99; 65 Supreme Court 1464; 89 L. Ed. 2079 (1944), stated as follows at 326 U. S. at pages 108 and 109:

> ". . . But since a federal court adjudicating a State-created right solely because of the diversity of citizenship of the parties is for that purpose, in effect, only another court of the State, it cannot afford recovery if the right to recover is made unavailable by the State nor can it substantially affect the enforcement of the right as given by the State.
> ". . . The nub of the policy that underlies *Erie R. Co. v. Tompkins* is that for the same transaction the accident of a suit by a non-resident litigant in a federal court instead of in a State court a block away should not lead to a substantially different result."

Thus, applying the "Outcome of Litigation Rule" to the instant case, in light of this Honorable Court's decision, we are confronted with the following situation:

In the State court the plaintiff would be required to deposit a bond prior to issuance of summons and prior

to having the right to summon a defendant into court in a libel or slander action; but the same plaintiff, in the light of such decision*, could now, figuratively speaking, walk across the street and file his action with the clerk of the United States District Court and have summons issued and summon the defendant into court without the filing of any bond whatsoever.

The defendant would be required to appear and possibly at some stage of the proceedings the action would be dismissed or the defendant might prevail. In a State court the defendant could then look to plaintiff's bond. In the Federal court there would be no bond on file. This would result in the very evil pointed out in the *Cohen Executrix v. Beneficial Industrial Loan Corp., supra.* Thus, this Court in determining that Section 1 (of Act 4317) relates to State court actions, not to Federal court actions has created a conflict in the basic law of the land as laid down by the famous case of *Erie R. Co. v. Tompkins,* 304 U. S. 64, 58 Supreme Court 817, 82 L. Ed. 1188 (1937), and its progeny which have followed the *Erie R. Co.* case faithfully since that far-reaching decision was first announced. The progeny, of course, includes the *Cohen Executrix v. Beneficial Industrial Loan Corp.* (*supra*) case.

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*See page 2 of decision: "Section 1 relates to State court actions, not to Federal court actions. In the Federal courts compliance with Rule 4(a) is required in all civil actions, including actions for libel."

ARGUMENT ON GROUND IV.

That the Failure of the Clerk to Issue Summons Forthwith, as Required by Rule 4(a) of the Federal Rules of Civil Procedure, Was Occasioned Solely by the Failure of the Appellant to File With the Clerk at the Time Appellant Filed His Complaint, a Bond as Required by the Substantive Law of the State of California.

We respectfully submit that when appellant chose the United States District Court as the forum in which to maintain his libel action, he was not only bound by the Rules of such court, but a duty developed upon him to furnish the clerk of the court with the bond required by Act 4317, *supra,* at the time he presented his complaint for filing to the end that the clerk would be enabled to comply with Rule 4(a) of the Federal Rules of Civil Procedure and issue the summons "forthwith." We further respectfully submit that it was appellant's failure to furnish the bond that prevented the clerk from complying with Rule 4(a), and that the fault is clearly attributable solely to appellant.

While it is probably true that the United States District Court at all times had *jurisdiction* over the parties, it will be noted that the trial court's Order of Dismissal was based on *two* grounds. The *first* (and thus presumably the more important) was the fact that appellant failed to comply with Rule 4(a) and the action was, therefore, ordered dismissed under the provisions of Rule 41(b) of the Federal Rules of Civil Procedure.

A failure of the trial court to dismiss the action upon appropriate motion in these circumstances would be tantamount, it is respectfully submitted, to holding that Rule 4(a) was a nullity. The refusal of the clerk to issue the summons "forthwith" was attributable, as heretofore pointed out, solely to the failure of appellant to comply with the substantive laws of the State of California, to wit, Act 4317 of Deering's General Laws.

Summary.

We respectfully submit:

1. That Act 4317 of Deering's General Laws of the State of California is a substantive law binding upon the Federal court and which it is required to recognize; and

2. That the failure to issue the summons in accordance with Rule 4(a) was occasioned solely by the fault of the appellant in not furnishing a bond at the time of the filing of his complaint which would have thus enabled the clerk to issue the summons in accordance with Rule 4(a); and

3. That the holding by this Honorable Court that "Section 1 (of Act 4317) relates to State court actions, not to Federal court actions" is not in accordance with United States Supreme Court decisions as applied to analogous statutes and does not follow the "Outcome of Litigation Rule." Further, such decision, if allowed to stand, would clearly deprive a defendant in the Federal court of certain substantive rights to which he is entitled in the State court.

For the reasons hereinabove stated, it is respectfully submitted that the within Petition for Rehearing should be granted.

Respectfully submitted,

BINFORD & BINFORD,
L. B. BINFORD,
HOWARD M. BINFORD,

Attorneys for ~~Appellant~~. appellee

Certificate of Counsel Under Rule 25 United States Court of Appeals.

I hereby certify that in my opinion the grounds as stated in the foregoing Petition for Rehearing are well founded and said Petition is not interposed for the purpose of delay.

HOWARD M. BINFORD.

No. 12881

United States Court of Appeals

for the Ninth Circuit.

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

Petitions to Review Decisions of the Tax Court of the United States.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

No. 12881

United States Court of Appeals for the Ninth Circuit.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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APPEARANCES

For Petitioner:

GEORGE H. KOSTER, ESQ.

For Respondent:

EARL C. CROUTER, ESQ.

The Tax Court of the United States
Docket No. 8993

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, a National Banking Association,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1945

Aug. 21—Petition received and filed. Taxpayer notified. Fee paid.

Aug. 21—Copy of petition served on General Counsel.

Oct. 9—Answer filed by General Counsel.

Oct. 9—Request for hearing in San Francisco filed by General Counsel.

Oct. 11—Notice issued placing proceeding on San Francisco calendar. Service of answer and request made.

1946

May 27—Motion for leave to file amended petition and amended petition lodged, filed by taxpayer. 5/28/46 Granted.

1946

May 29—Copy of motion and amended petition served on General Counsel.

June 19—Answer to amended petition filed by General Counsel. Served 6/20/46.

1949

Sept. 20—Motion to place on San Francisco, Calif., calendar Nov. 7, 1949, filed by taxpayer. 9/21/49 Granted.

Sept. 22—Hearing set Nov. 7, 1949, at San Francisco, California.

Nov. 7—Hearing had before Judge Harron on merits. Respondent's motion for leave to file amendment to answer—granted. Petitioner allowed usual time to answer if desired. Respondent's motion to file amendment to answer—granted and amendment to answer filed. Copies served. Stipulation of facts filed at hearing. Briefs due Dec. 28, 1949. Replies due Jan. 26, 1950.

Dec. 7—Transcript of hearing 11/7/49 filed.

Dec. 28—Brief filed by taxpayer. Copy served, 12/29/49.

Dec. 28—Brief filed by General Counsel. Copy served.

1950

Jan. 6—Reply brief filed by taxpayer. 1/17/50. Copy served.

Jan. 25—Reply brief filed by General Counsel. Copy served.

Oct. 20—Findings of fact and opinion rendered, Judge Harron. Decision will be entered under rule 50. Copy served.

Nov. 22—Respondent's computation filed.

Nov. 27—Hearing set December 20, 1950, on Respondent's computation.

Dec. 20—Hearing had before Judge Kern on settlement. Referred to Judge Harron.

Dec. 22—Decision entered. Judge Harron. Div. 13.

1951

Feb. 9—Petition for review by U. S. Court of Appeals, Ninth Circuit, with assignments of error filed by taxpayer.

Feb. 26—Notice of filing petition for review with affidavit of service of petition for review attached thereon, filed.

Feb. 26—Statement of points with affidavit of service attached thereon, filed by taxpayer.

Feb. 26—Designation of contents of record filed by taxpayer with affidavit of service attached thereon.

[Title of Tax Court and Cause.]

MOTION FOR LEAVE TO FILE AMENDED PETITION

Comes now the taxpayer, Bank of America National Trust and Savings Association by its counsel, George H. Koster, and moves this honorable court to grant the said taxpayer leave to file the amended petition attached hereto.

This motion is based upon the following grounds:

1. Since the original petition was filed herein, additional franchise taxes based upon the petitioner's income for the year 1942 have been assessed and collected from petitioner. In the original petition, petitioner alleged that it was informed and believed that additional franchise taxes for said year would be assessed and assigned as error, the failure to allow deduction for said additional franchise taxes. The amended petition sets forth the exact amount of the additional franchise taxes which exact amount exceeds the amount alleged in the original petition. As the petitioner keeps its books and records on an accrual basis, it is believed that said additional franchise taxes are a proper deduction of the year for which the assessment is made rather than the year in which the tax is paid.

2. Since the original petition herein was filed, it has been determined that petitioner understated the deduction to which it was entitled for depreciation of certain bank buildings. The amended peti-

tion sets forth the facts with regard to said depreciation and assigns as error the failure to allow said additional depreciation.

Respectfully submitted,

/s/ GEORGE H. KOSTER,
Counsel for Petitioner.

Received and Filed T.C.U.S. May 27, 1946.

Granted May 28, 1946. Bolan B. Turner, Judge.

Served May 29, 1946.

The Tax Court of the United States
Docket No. 8993

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, a National Banking Association,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

AMENDED PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency, IRA:90-D HVH, dated June 5, 1945, and as a basis of its proceeding alleges as follows:

1. The petitioner is a national banking association with principal office at 300 Montgomery Street,

San Francisco, California. The return for the period here involved was filed with the collector for the First District of California, San Francisco, California.

2. The notice of deficiency (a copy of which is attached to the original petition herein as Exhibit A* is hereby referred to and by this reference, made a part hereof) was mailed to petitioner on June 5, 1945.

3. The taxes in controversy are income taxes for the calendar year 1943 in the amount of $1,075,697.43, consisting of a proposed deficiency of $915,040.93 and a claimed overpayment of $160,656.50, and declared value-excess profits taxes for the calendar year 1943 in the amount of $163,465.77, consisting of a proposed deficiency of $161,650.70 and a claimed overpayment of $1,815.07.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Commissioner erred in disallowing a loss in the amount of $464,811.68 sustained by the petitioner during the year 1943 upon the sale of certain bank premises.

(b) The Commissioner erred in disallowing as a deduction for 1943 California franchise taxes in the amount of $1,801,764.30 based upon the net income of the petitioner for the calendar year 1943.

(c) The Commissioner erred in failing to allow

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*See Page 16 of this Printed Record.

an additional deduction in the amount of $50,000 for additional California franchise taxes based upon net income of petitioner for the calendar year 1943.

(d) Commissioner erred in failing to allow an additional deduction in the amount of $204,790.58 for additional franchise taxes based upon the net income of petitioner for the calendar year 1942.

(e) The Commissioner erred in reducing the allowance for depreciation of fixtures owned by petitioner and used in its business by the amount of $189,394.10.

(f) The Commissioner erred in reducing the allowance for depreciation of furniture owned by petitioner and used in its business by the amount of $91,948.68.

(g) The Commissioner erred in failing to increase the deduction for depreciation of banking premises by the amount of $55,810.78.

(h) The Commissioner erred in determining a deficiency in income taxes and declared value-excess profits taxes against the petitioner for the year 1943 in any amount.

(i) The Commissioner erred in failing to determine that petitioner overpaid its income tax for the year 1943 by the amount of $160,656.50 and over-paid its declared value-excess profits tax for the year 1943 by the amount of $1,815.07.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) Petitioner is a national banking association with its principal place of business in the City and County of San Francisco, California.

(b) Petitioner duly filed its income and declared value-excess profits tax return for the calendar year 1943 on March 14, 1944, with the Collector of Internal Revenue for the First District of California at San Francisco, California. Said return disclosed a liability for income taxes in the amount of $5,126,122.84 and a liability for declared value-excess profits taxes in the amount of $1,815.07. Said taxes were duly paid to the Collector of Internal Revenue for the First District of California at San Francisco, California, as follows:

$1,281,984.48 on March 14, 1944;

$1,281,984.48 on June 12, 1944;

$1,281,984.48 on September 11, 1944;

$1,281,984.47 on December 13, 1944.

(c) Petitioner keeps its books and records and makes its income tax returns on the accrual basis.

(d) During the year 1943 petitioner sold several parcels of real property used by it as banking premises to Capital Company, a California corporation, for a total consideration of $2,853,459.39. The total cost to the petitioner of all of said properties was $4,232,195.06. The total adjusted basis for gain or loss on the sale or exchange of said properties of petitioner was $3,315,130.02. Petitioner incurred and paid expenses in connection with the sale of said properties in the total amount of $3,-141.05. Petitioner sustained losses upon the sales of said properties during the year 1943 in the total amount of $464,811.68. Said losses in said total

amount of $464,811.68 were allowable deductions for income tax purposes. Respondent erroneously disallowed the entire amount of said loss in determining petitioner's net income for the year 1943.

(e) On December 31, 1943, petitioner became liable to the State of California for franchise taxes in the amount of $1,801,764.30 based upon its net income for the calendar year 1943. On December 31, 1943, said franchise taxes accrued under the law of California and became a lien upon the real property of petitioner which lien had the same force and priority as a judgment lien. Said tax accrued as a liability of petitioner during the year 1943 and was allowable as a deduction for the year 1943 for income tax purposes. Petitioner deducted said franchise taxes in its income and declared value excess profits tax return for the year 1943. Respondent erroneously disallowed the entire amount of said deduction for franchise taxes.

(f) Petitioner is informed and believes and upon the basis of such information and belief alleges that additional franchise taxes based upon its net income for the year 1943 will be assessed and collected from petitioner in an amount not less than $50,000. Said additional franchise taxes will constitute an accrued liability of petitioner for the year 1943, and are a deductible expense for the year 1943 for income tax purposes. In recomputing petitioners net income for the year 1943, respondent allowed no deduction for said additional franchise taxes.

(g) During the year 1946, additional California

Bank and Corporation franchise taxes based upon and measured by petitioner's net income for the year 1942, were assessed and collected from petitioner in the amount of $270,156.07. Said additional franchise taxes constituted an accrued liability of petitioner for the year 1943 and were a taxable expense of the petitioner for said year 1943 for income tax purposes. In recomputing petitioner's net income for the year 1943, respondent allowed as a deduction only $65,365.49 of said additional franchise taxes based upon petitioner's net income for the year 1942 and erroneously failed and refused to allow as a deduction the remaining $204,790.58 of said additional franchise taxes.

(h) During the year 1943, petitioner owned furniture and fixtures which it used in its business and which had been acquired at various times at a total cost of $6,577,354.57 for the furniture and $9,726,795.64 for fixtures. A reasonable allowance for the depreciation of said furniture and fixtures for the year 1943 under the provisions of Section 23(1) of the Internal Revenue Code was not less than $312,949.41 for said furniture and $513,721.94 for said fixtures. Petitioner deducted said amounts in its income and declared value-excess profits tax return for the year 1943. Respondent reduced said deductions by amounts of $91,948.68 for the furniture and $189,394.10 for the fixtures and allowed revised deductions for depreciation in the amount of $221,000.73 for the furniture and $324,327.84 for the fixtures. The adjustments made by respondent of the deductions taken by petitioner for depre-

ciation of its furniture and fixtures were erroneous and the amounts allowed by the respondent do not constitute a reasonable allowance for depreciation within the provisions of Section 23(1) of the Internal Revenue Code.

(i) During the year 1943, petitioner owned certain banking premises including the buildings thereon which buildings had a cost to petitioner of $23,-005,523.26. Under the provisions of Section 23(1) of the Internal Revenue Code, petitioner was entitled to a reasonable allowance for the depreciation of said buildings. A reasonable allowance for the depreciation of said buildings during the year 1943 was not less than $328,508.45. In its income and declared value-excess profits tax return for the year 1943, petitioner inadvertently understated the deduction to which it was entitled for depreciation of said banking premises and deducted on said return the sum of $272,697.67. Petitioner inadvertently understated the deduction for depreciation on banking premises by the amount of $55,810.78. In recomputing petitioner's net income for the year 1943, respondent allowed additional depreciation on banking premises in the amount of $5,810.78 and erroneously failed and refused to allow as a deduction the remaining $50,000 which petitioner was entitled to deduct as depreciation on banking premises.

(j) As the result of the failure and refusal of the respondent to allow the deductions set forth herein, respondent overstated petitioner's net income for the year 1943 by the amount of $2,852,-

709.34 and erroneously determined that petitioner was liable for deficiencies in income taxes and declared value-excess profits taxes for the year 1943.

(k) In its income and declared value-excess profits tax return for the year 1943, petitioner inadvertently overstated its net income by the amount of $403,443.41 and overpaid its declared value-excess profits taxes by the amount of $1,815.07 and overpaid its income taxes by the amount of $160,656.50. No part of said taxes overpaid by petitioner have been refunded to petitioner.

Wherefore petitioner prays that this Court may hear the proceeding and determine that there is no deficiency of income taxes or declared value-excess profits taxes due from petitioner for the year 1943; that petitioner overpaid its income taxes and declared value-excess profits taxes for the year 1943; that petitioner is entitled to the refund of the taxes overpaid by it for the year 1943; and for such other and further relief as may be proper.

/s/ GEORGE H. KOSTER,
Counsel for Petitioner.

State of California,
City and County of San Francisco—ss.

R. G. Smith, being duly sworn, says that he is the Executive Vice President of the Bank of America National Trust and Savings Association, the petitioner herein, and is duly authorized to verify the foregoing petition; that he has read the foregoing petition, or had the same read to him, and is familiar with the statements contained therein, and

that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

/s/ R. G. SMITH.

Subscribed and sworn to before me this 23rd day of May, 1946.

[Seal] /s/ JOHN H. BURNS,
Notary Public in and for the City and County of San Francisco, State of California.

My Commission expires April 12, 1949.

Lodged T. C. U. S. May 27, 1946.

Filed T. C. U. S. May 28, 1946.

Served May 29, 1946.

EXHIBIT A

To the original petition.

Treasury Department
Internal Revenue Service
San Francisco 5, California

June 5, 1945

Office of Internal Revenue Agent in Charge
San Francisco Division
74 New Montgomery Street

IRA:90-D
HVH
Bank of America National Trust and Savings Association

300 Montgomery Street
San Francisco, California

Gentlemen:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1943, discloses a deficiency of $915,040.93 and that the determination of your declared value excess-profits tax liability for the year mentioned discloses a deficiency of $161,650.70 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may

file a petition with the Tax Court of the United States for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, 74 New Montgomery Street, San Francisco 5, California, for the attention of Conference Section. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,
Commissioner.

By /s/ F. M. HARLESS,
Internal Revenue Agent in Charge.

Enclosures:
Statment
Form of waiver.

Statement

San Francisco
IRA :90-D
HVH

Bank of America National Trust and
Savings Association
300 Montgomery Street
San Francisco, California

Tax Liability for the Taxable Year Ended December 31, 1943

	Liability	Assessed	Deficiency
Income Tax	$6,041,163.77	$5,126,122.84	$915,040.93
Declared Value excess-profits Tax	163,465.77	1,815.07	161,650.70

This determination of your income tax liability and declared value excess-profits tax liability has been made upon the basis of information on file in this office.

In making this determination of your income tax liability and declared value excess-profits tax liability, it is noted that you requested the issuance of a deficiency notice for the year 1943, without the privilege of first filing a protest.

Adjustments to Net Income

Net income for declared value excess-profits tax computation as disclosed by return		$17,544,414.55
Unallowable deductions and additional income:		
(a) Loss on the sale of assets other than capital assets	$ 449,055.24	
(b) Social security tax	11,558.53	
(c) California franchise tax	1,736,398.81	
(d) Depreciation	267,299.86	
(e) Rent	14,438.31	
(f) Dividends	15.18	2,478,765.93
Total		$20,023,180.48
Nontaxable income and additional deductions:		
(g) Capital stock tax		29,500.00
Net income for declared value excess-profits tax computation as adjusted		$19,993,680.48

Explanation of Adjustments

(a) Net loss claimed on the sale of assets other than capital assets is decreased $449,055.24 as follows:

(1) Loss on the sale of bank premises disallowed	$464,811.68
(2) Loss on the sale of Torrence property increased	15,756.44
Net decrease in loss	$449,055.24

(1) Net loss claimed on the sale of assets other than capital assets includes losses of $464,811.68 on the sale of certain banking premises to the Capital Company. The Capital Company held legal title to these properties for a period of one month and received rent from you for such period of ownership. The properties were then sold by the Capital Company to the Merchants National Realty Corporation, your wholly owned subsidiary.

The Transamerica Corporation controlled all of the outstanding shares of the Capital Company. Approximately 22 per cent of your stock was owned by the Transamerica Corporation group.

Under date of August 1, 1936, you entered into an agreement with the Merchants National Realty Corporation whereby you leased from the Merchants National Realty Corporation certain banking premises. The rental was to be an amount equal to the total of all expenses and charges of the lessor allowable to said lessor as deductions from gross income for federal income tax purposes, less an amount equal to the total income of the lessor derived from all other sources. The result of this agreement is that all operations of the Merchants National Realty Corporation were merged with your operations, leaving no income of the Merchants National Realty Corporation subject to income tax.

It is held that no deductible loss resulted from the sale of banking premises to the Capital Company. Your taxable income is, therefore, increased $464,811.68.

(2) During 1941 you acquired the Torrence property from the Merchants National Realty Corporation, your wholly owned subsidiary. A loss of $47,307.34 on this transaction as claimed by your subsidiary in its 1941 return was disallowed. During 1943 you sold the commercial portion of the property and claimed a loss of approximately $8,500.00 on the sale. The loss claimed on the portion sold during 1943 is increased $15,756.44 due to the adjustment of the cost basis to take into consideration the disallowance of the loss claimed for 1941.

(b) Social security tax of $11,558.53 paid during 1943 for the years 1940, 1941 and 1942 does not constitute an allowable deduction from 1943 income and is, therefore, disallowed.

(c) The deduction for California franchise tax is decreased $1,736,-398.81 as follows:

	Claimed	Allowed	(Increase) Decrease
(1) Tax based on 1943 net income	$1,801,764.30	None	$1,801,764.30
(2) Tax based on 1942 net income	1,319,388.51	$1,384,754.00	(65,365.49)
Totals	$3,121,152.81	$1,384,754.00	$1,736,398.81

(1) California franchise tax claimed in the amount of $1,801,764.30, representing franchise tax for the year 1944, is disallowed, since it is held that this tax accrues as of the first day of the year 1944 and not on the last day of the year 1943.

Under the provisions of the California Bank and Corporation Franchise Act the amount of the franchise tax is based upon the income of the next preceding "income year." As the result of amendments enacted by the California Legislature, effective May 7, 1943, the date on which the franchise tax became a lien on the property of the corporation was changed from the first day of the "taxable year" to the last day of the "income year."

Notwithstanding the aforementioned amendment to the California statute, it is held that for federal income tax purposes, the franchise tax accrues as of the first day of the "taxable year" in which the franchise is exercised, since it is the exercise of such franchise that fixes the amount of the tax and the corporation's liability to pay it.

(2) An additional deduction of $65,365.49 for California franchise tax based on 1942 net income is allowed as follows:

Additions to 1942 net income		$1,010,202.82
Deductions from 1942 net income	$179,982.67	
Less: California franchise tax adjustment	117,105.85	
Net increase in 1942 income		$ 947,326.00
California franchise tax at 6.90 per cent on $947,326.00		$ 65,365.49

(d) The adjustment of depreciation results in a net decrease of $267,299.86 as follows:

	Claimed	Allowed	Adjustment
Fixtures	$ 513,721.94	$324,327.84	$189,394.10
Furniture	312,949.41	221,000.73	91,948.68
Alterations leased premises	123,001.15	109,987.56	13,013.59
Expenditures capitalized prior to 1941	none	17,481.32	(17,481.32)
1942 building costs	none	1,372.83	(1,372.83)
Other 1942 costs	none	2,391.58	(2,391.58)
(1) Banking premises acquired from subsidiary	272,697.67	278,508.45	(5,810.78)
Totals	$1,228,180.95	$960,881.09	$267,299.86

(1) Additional depreciation of $5,810.78 is allowed on banking premises acquired by you from your wholly owned subsidiary, Mer-

hants National Realty Corporation. The increase results from the adustment of the cost basis due to the disallowance of losses on sales of he premises as claimed by the subsidiary on its 1941 and 1942 returns.

(e) The deduction for rent paid to the Merchants National Realty Corporation consists of the total expenses and charges of such lessor ompany which are allowable for income tax purposes, less an amount qual to the total income of such lessor derived from all sources. Exmination of the records of the Merchants National Realty Corporation iscloses the following net decrease in expenses and allowable deducions of that company:

(1) Depreciation	$34,918.34
Less:	
(2) Loss on the sale of real estate increased	20,480.03
Net decrease	$14,438.31

(1) Depreciation is decreased as follows:

Decrease in depreciation claimed on properties other than properties acquired from you during 1941, 1942 and 1943	$56,735.77
Depreciation on properties acquired from you during 1941, 1942 and 1943. (Adjustment due to increase in cost basis due to disallowance of losses on sales to you)	21,817.43
Depreciation decreased	$34,918.34

(2) Loss on the sale of real estate is increased as follows:

(A) Increase due to depreciation adjustments to other than Hynes property	$10,648.97
(B) Increase in loss on Hynes property	9,831.06
Total increase	$20,480.03

(A) Loss on the sale of real estate is increased due to the adjustment of the cost basis resulting from changes in the depreciation allowance made for prior years.

(B) Additional loss on Hynes property is computed as follows:

Cost basis increased due to previous disallowance of loss on sale by you		$10,212.98
Depreciation allowed	$946.22	
Depreciation considered in computation of loss as reported	564.30	381.92
Additional loss		$ 9,831.06

(f) Dividend income is increased $15.18 as follows:

Dividends received from South San Francisco Land and Improvement Company	$673.33
Taxable portion—16.4872 per cent of $673.33	$111.01
Amount reported	95.83
Increase	$ 15.18

(g) The deduction for capital stock tax is increased $29,500.00 as follows:

Tax at $1.25 on declared value of $230,000,000.00 as of June 30, 1944, which accrued July 1, 1943	$287,500.00
Amount claimed	258,000.00
Increase	$ 29,500.00

Computation of Declared Value Excess-Profits Tax

Net income for declared value excess-profits tax computation		$19,993,680.48
Less: 10 per cent of $175,000,000.00, value of capital stock as declared in your capital stock tax return for the year ended June 30, 1943	$17,500,000.00	
Dividends received credit	16,926.42	
		17,516,926.42
Balance subject to declared value excess-profits tax		$ 2,476,754.06
Amount taxable at 6.6 per cent—$2,476,754.06 and tax		163,465.77
Declared value excess-profits tax assessed:		
Original, Account No. 410257—First California Dist.		1,815.07
Deficiency of declared value excess-profits tax		$ 161,650.70

Computation of Income Tax

Net income for declared value excess-profits tax computation		$19,993,680.48
Add: Interest on obligations of certain instrumentalities of the U. S. issued prior to March 1, 1941	$932,302.99	
Less: Amortizable bond premiums	336,336.44	595,966.55
Total		$20,589,647.03
Less: Declared value excess-profits tax		163,465.77
Net income		$20,426,181.26
Less: Interest on certain obligations of the U. S. and its instrumentalities issued prior to March 1, 1941		8,843,909.00
Adjusted net income		$11,582,272.26

Less: Dividends received credit		$ 16,926.42
Normal-tax net income		$11,565,345.84

Normal Tax Computation

Normal-tax net income	$11,565,345.84	
Tax at 24 per cent on $11,565,345.84		2,775,683.00
Total normal tax		$2,775,683.00

Surtax Computation

Net income	$20,426,181.26	
Less: Dividends received credit	16,926.42	
Surtax net income	$20,409,254.84	
Tax at 16 per cent on $20,409,254.84	$ 3,265,480.77	
Total surtax		3,265,480.77
Total normal tax and surtax		$6,041,163.77
Total income tax assessable		$6,041,163.77
Income tax assessed:		
Original, Account No. 410257—First California Dist.		5,126,122.84
Deficiency of income tax		$ 915,040.93

Filed T.C.U.S. August 21, 1945.

[Title of Tax Court and Cause.]

ANSWER TO AMENDED PETITION

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the amended petition filed by the above-named petitioner, admits and denies as follows:

1, 2 and 3. Admits the allegations contained in paragraphs 1, 2 and 3 of the amended petition.

4 and 4(a) to (i), inclusive. Denies that the Commissioner erred in the determination of the deficiencies as alleged in paragraph 4 of the amended petition and subparagraphs (a) to (i), inclusive, thereunder.

5(a) to (c), inclusive. Admits the allegations contained in subparagraphs (a) to (c), inclusive, of paragraph 5 of the amended petition.

5(d) to (f), inclusive. Denies the allegations contained in subparagraphs (d) to (f), inclusive, of paragraph 5 of the amended petition.

5(g). For lack of information, denies the allegations contained in subparagraph (g) of paragraph 5 of the amended petition.

5(h). Admits that during the year 1943 petitioner owned furniture and fixtures which it used in its business and which had been acquired at various times. Admits that petitioner deducted $312,949.41 for furniture and $513,721.94 for fixtures as depreciation in its income and declared value excess profits tax return for the year 1943. Admits that respondent reduced said deductions by amounts of $91,948.68 for the furniture and $189,394.10 for the fixtures and allowed revised deductions for depreciation in the amount of $221,000.73 for the furniture and $324,327.84 for the fixtures; denies the remaining allegations contained in subparagraph (h) of paragraph 5 of the amended petition.

5(i). Admits that during the year 1943 petitioner owned certain banking premises including the build-

ings thereon, but denies the remaining allegations contained in subparagraph (i) of paragraph 5 of the amended petition.

5 (j) and (k). Denies the allegations contained in subparagraphs (j) and (k) of paragraph 5 of the amended petition.

6. Denies generally and specifically each and every allegation in the amended petition not hereinbefore admitted, qualified.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ J. P. WENCHEL,
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel;

T. M. MATHER,
Special Attorney, Bureau of
Internal Revenue.

Received and Filed T. C. U. S. June 19, 1946.

Served June 20, 1946.

[Title of Tax Court and Cause.]

MOTION FOR LEAVE TO FILE AMENDMENT TO ANSWER ASKING FOR INCREASED DEFICIENCIES

Comes Now the Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and moves that the Court grant leave for respondent to file the attached amendment to the answer asking for increased deficiencies in this proceeding. In support of this motion respondent respectfully represents as follows:

1. The Commissioner, in the deficiency notice of June 5, 1945, determined deficiencies against this petitioner for the taxable year ended December 31, 1943, as follows:

Income Tax Deficiency
$915,040.93

Declared Value Excess-Profits
Tax Deficiency
$161,650.70

2. The respondent, subsequent to the making of the said determinations of deficiencies, has examined new evidence and has made additional adjustments with respect to income and deductions of the petitioner for the same taxable year, as more fully set forth in the proposed amendment attached hereto, resulting in increases in deficiencies as now

determined by the respondent and claimed herein, as follows:

Income Tax	DVEP Tax
$27,296.45	$4,822.17

3. By reason of the foregoing, the true and correct total deficiencies determined by the respondent and claimed from the petitioner in this proceeding now are:

Income Tax Deficiency
$942,337.38

Declared Value Excess-Profits
Tax Deficiency

$166,472.87

4. The various adjustments resulting in the above-mentioned increased deficiencies have been discussed with the petitioner's counsel before this Court, and it is understood that there is no real controversy as to these adjustments, and that the petitioner does not oppose the filing or granting of this motion.

Wherefore, it is prayed that this motion be granted.

CHARLES OLIPHANT, ECC
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

T. M. MATHER,
E. C. CROUTER,
Special Attorneys, Bureau of Internal Revenue.

No objection:

/s/ GEORGE H. KOSTER,
Counsel for Petitioner.

Filed T. C. U. S. November 7, 1949.

Granted November 7, 1949. Marion J. Harron, Judge.

Served November 7, 1949.

[Title of Tax Court and Cause.]

AMENDMENT TO ANSWER ASKING FOR INCREASED DEFICIENCY

The Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, as an amendment to his answer on file in this proceeding, alleges as follows:

1. That the Commissioner of Internal Revenue in his determination of deficiencies reflected by deficiency notice of June 5, 1945, which forms the basis of this proceeding, determined deficiencies as follows:

Income Tax Deficiency
$915,040.93

Declared Value Excess-Profits
Tax Deficiency
$161,650.70

2. That the Commissioner, since the making of the above-mentioned deficiency determinations, has made further examinations and determinations with respect to the petitioner's income tax and declared value excess-profits tax liabilities for the taxable year 1943, and has considered additional evidence relating to such liabilities.

3. That the Commissioner has now determined that the petitioner, for the said taxable year ended December 31, 1943, had additional net income in the amount of $73,063.27, based upon the following adjustments:

Net income for d.v.e.p. tax computation as disclosed by report dated 5/18/45		$19,993,680.48
As corrected		20,066,743.75
Net adjustment as computed below		73,063.27
Unallowable deductions and additional income:		
(a) Rent—Merchants National Realty Corp.	$17,180.01	
(b) San Clemente Trust	19,993.02	
(c) Real Estate taxes	11,247.09	
(d) Reimbursement on leasehold improvements	1,412.80	
(e) Interest	226.02	
(f) Gain on sale of other real estate	34,219.48	
(g) California franchise tax	65,365.49	
Total		149,643.91
Nontaxable income and additional deductions:		
(h) Taxes	$19,358.05	
(i) Insurance	9,477.21	
(j) Depreciation	47,745.38	
Total		76,580.64
Net adjustment		$ 73,063.27

4. That by reason of the foregoing the petitioner's true and correct tax deficiencies for the said taxable year, based upon all of the grounds of determination reflected in the original deficiency notice and the redetermination stated above, now are as follows:

Income Tax Deficiency	Declared Value Excess-Profits Tax Deficiency
$942,337.38	$166,472.87

5. The respondent therefore respectfully requests that this Court redetermine the petitioner's income and declared value excess-profits tax deficiencies to be in the amounts stated in paragraph 4 supra, claim for which increased deficiencies is hereby made in this proceeding.

Wherefore, the respondent prays that this Court redetermine the deficiencies herein to be

	Income Tax Deficiency	Declared Value Excess-Profits Tax Deficiency
Original	$915,040.93	$161,650.70
Increased	27,296.45	4,822.17
Total	$942,337.38	$166,472.87

claim for which is hereby made pursuant to the provisions of Section 272(e) of the Internal Revenue Code.

/s/ CHARLES OLIPHANT, ECC
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

T. M. MATHER,
E. C. CROUTER,
Special Attorneys, Bureau of Internal Revenue.

Filed T. C. U. S. November 7, 1949.

Served November 7, 1949.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto through their respective counsel that in addition to the facts admitted by the pleadings, the following facts shall be taken as true, pro-

vided, however, that this stipulation shall be without prejudice to the rights of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true.

1. In a report of examination of the Bank of America National Trust and Savings Association, the petitioner (hereinafter referred to as the Bank), in 1939 by the bank examiners of the office of the United States Comptroller of the Currency, the examiners criticized the Bank for several things and made the contention that the Bank was carrying its banking premises on its books at figures in excess of value and recommended that the Bank be required to charge off a substantial portion of its banking premises account.

2. After a number of conferences and exchanges of correspondence between the Bank and the office of the Comptroller of the Currency, an agreement was reached on March 6, 1940, upon a method of procedure for settling differences and disputes. The question concerning the valuation of banking premises was covered in paragraph 5 of this agreement which was known as "Requirements of the Comptroller of the Currency," reading as follows:

"The Bank shall, as soon as possible, furnish to a committee composed of the Vice President in Charge of Examinations of the Federal Reserve Bank of San Francisco, or some officer of the Bank designated by him, the Supervising Examiner of the Federal Deposit Insurance Corporation for the Twelfth District, and the Chief National Bank Examiner for the Twelfth Federal Reserve District,

all obtainable records and information with respect to the acquisition of each banking premise criticized in the report of examination of August 31, 1939, including those shown on the Bank's books and in its investment in Merchants National Realty Corporation, dating back to the time such premise was acquired either by the Bank or any member (either bank or company) of the group presently or then comprising the Transamerica organization. The committee shall consider the fair value of each premise at the time of such acquisition, and the special conditions which had to be met in fixing the price paid. From these considerations, the committee shall determine the amount which shall be used by the committee as the estimated cost amount of each premise to the Bank. The value of each premise shall then be established at such estimated cost amount, plus the amount of any expenditures subsequent to acquisition found by the committee to have been appropriately capitalized, less the appropriate amount of depreciation at the depreciation rate allowed by the Bureau of Internal Revenue for each year of ownership. The unallocated reserve set up by the Bank shall be reduced by the difference between the present carrying value of each such premise and the value of such premise as determined by the committee in the manner hereinabove stated. The decision of a majority of the members of the committee shall be binding. The remainder of such reserve, if any, may be returned to the undivided profits account. A partial release of the reserve, or a decrease in the amount of the reserve to be set up, may be

made as soon as that procedure is justified, in the opinion of the committee."

3. After several conferences between the Bank and the Office of the Comptroller of the Currency with respect to the settlement of said Requirement 5, an understanding was reached as set forth or referred to in letters dated March 11, 1941; June 16, 1941; June 17, 1941; December 9, 1941; March 20, 1942, and April 11, 1942, copies of which are hereto attached as Exhibits 1-A to 6-F, inclusive.

4. The Bank operates a branch banking system in California through approximately 500 branches and it and Merchants National Realty Corporation, its wholly owned subsidiary (hereinafter referred to as Merchants), owned most of the banking premises in which this business was conducted. During this controversy with the Comptroller, the Bank had maintained the position that it had the right to carry its banking premises on its books at cost less normal depreciation and that the Comptroller had no authority to require a write-down of the banking premises account; and, when the Bank agreed with the Comptroller to reduce its banking premises account in order to settle the issue with the Comptroller, it did so in the manner stated below to which the Comptroller had no objection.

5. On account of the foregoing, the following transactions were effected:

(a) In the years 1941 and 1943, the Bank executed and delivered to Capital Company deeds with respect to certain banking premises. After thirty

days or so after the time Capital Company received the said deeds, Capital Company executed and delivered deeds to said property to Merchants. The schedule attached hereto and marked Exhibit 8-H identifies the properties involved in the transaction and shows information concerning the transaction as indicated in said schedule.

(b) In the years 1941 and 1942 Merchants executed and delivered to Capital Company deeds with respect to certain banking premises. After thirty days or so after Capital Company received these deeds, Capital Company executed and delivered deeds to said property to the Bank. The schedule attached hereto and marked Exhibit 9-I identifies the properties involved in the transaction and shows information concerning the transaction as indicated in said schedule.

(c) Prior to the transactions described in the preceding sub-paragraphs (a) and (b), Mr. R. G. Smith, Vice President of the Bank, talked to Mr. E. C. Woodruff, President of Capital Company, a company engaged in the real estate business, and explained the Bank's controversy with the Comptroller, and the following agreement was reached between Messrs. Smith and Woodruff in behalf of their respective companies:

That the Bank or Merchants would execute deeds to Capital Company with respect to the banking premises described in Exhibits 8-H and 9-I attached; that Capital Company would accept delivery of such deeds; that Capital Company would deliver its checks to the Bank and to Merchants in amounts

equal to the value of said premises as appraised by the American Appraisal Company; that the Bank intended to and would receive back, deeds to the said property within thirty days or so after delivery of deeds thereto to Capital Company, and Capital Company agreed to execute and deliver deeds to said property to the Bank or Merchants at any time upon request of the Bank; that there would not be any written agreement between the Bank, Merchants and Capital Company providing for the execution and delivery of deeds from Capital Company to the Bank or to Merchants; that when the Bank requested delivery of deeds to such property from Capital Company to it or to Merchants, the Bank or Merchants would give its check to Capital Company for the same amount of the check which Capital Company gave the Bank or Merchants for the respective property, plus acquisition costs incurred by Capital Company in connection with the transaction; and that between the time of the delivery of the deeds with respect to the respective properties from the Bank or from Merchants to Capital Company, and the time of the delivery of the deeds with respect to the respective properties from Capital Company to the Bank or to Merchants, the Bank would pay to Capital Company as rental amounts equal to 6% per annum net upon the amounts paid by Capital Company to the Bank or to Merchants, as aforesaid.

The transactions described in sub-paragraphs (a), (b) and (c) above were effected pursuant to and in accordance with this agreement. When these trans-

actions were under contemplation, the Bank's officers were advised by the Bank's counsel that these transactions might result in a large deductible loss for income tax purposes. The Bank's officers thereupon instructed the Bank's counsel to make adequate disclosure of the transactions on the tax return so that the Internal Revenue Bureau would be fully informed thereof. The counsel's memorandum of his discussion of the matter with the Bank officials is attached hereto as Exhibit 14-N.

At all times mentioned herein the properties involved in the transactions referred to in sub-paragraphs (a) and (b) hereof were occupied and used by the Bank as branch banks and no discontinuance, change or transfer of such use was contemplated.

(d) The only action taken by the respective Boards of Directors of either the Bank, Merchants or Capital Company in connection with the transactions referred to in sub-paragraphs (a) and (b) above, was the action taken by the Board of Directors of Capital Company as set forth in resolutions, copies of which are attached as exhibits 11-K, 12-L and 13-M.

6. In carrying out the aforesaid transactions, all formalities in connection therewith, such as the execution and recording of deeds, the affixing of documentary stamp taxes, the transfer of fire insurance, and the recording of the transactions on the books of all companies as purchases and sales of property were complied with. When the properties were deeded to Capital Company, the outstanding fire insurance policies covering the respective properties

were amended by rider to provide that any loss payable thereunder should be paid to Capital Company; and when Capital Company deeded the properties to the Bank or to Merchants the policies were again amended by rider to provide that any loss payable thereunder should be paid to the Bank or to Merchants respectively. Upon the execution and delivery of the deeds to the respective properties by the Bank or Merchants to Capital Company, the Bank and Capital Company executed a "lease" agreement with respect to each property, a form of which lease agreement is attached as Exhibit 10-J, and the rentals received under said lease agreements were reported by Capital Company as rental income on its income tax return, and by the Bank as rental expense on its tax return.

7. During the years 1941 to 1943 inclusive, Merchants was a wholly owned subsidiary of the Bank. The only business of Merchants was the ownership of property and the rental of that property to the Bank for use as banking premises under a lease arrangement which is set forth in the written lease, copy of which is attached hereto as Exhibit 7-G. The properties deeded by Capital Company to Merchants as stated above, were thereafter held by Merchants under this lease. The officers and directors of Merchants during 1943 are listed in the schedule attached hereto as Exhibit 15-O. Merchants had no salaried employees; whatever work was necessary to the operation of the Company's business was performed by employees of the Bank.

8. The differences between the claimed income

tax basis and the amount at which Merchants transferred properties to Capital Company in the transactions referred to in sub-paragraph (b) of paragraph 4 above, were charged to losses by Merchants and became a part of the expenses entering into the formula under which the rental paid by the Bank to Merchants was computed, and so were included in computing the rental paid by the Bank to Merchants in the respective years and were deducted by the Bank on its income tax returns for the respective years as rental expenses.

9. The Respondent disallowed the amounts claimed as losses on the aforesaid transactions and computed allowable depreciation without recognizing any deeds or "sales" of property from the Bank to Capital Company and thence to Merchants. If the Court should hold that deductible losses for income tax purposes resulted from the aforesaid transactions, the amount thereof can be computed by the parties since there is no dispute as to the factors entering into the computation of gain or loss and it is agreed depreciation shall be adjusted accordingly. If the Court should hold that no deductible losses result from the aforesaid transactions, the Respondent's action in disallowing the losses should be sustained, and a recomputation of tax may be made under Rule 50 to give effect to the adjustment referred to in paragraph 12 hereof.

10. (a) During the years 1941 to 1943, inclusive, Capital Company was a wholly owned subsidiary of Transamerica Corporation. On the dates indicated, Transamerica Corporation and its affiliated

companies owned shares of the outstanding capital stock of the Bank as follows:

Date		Common	Preferred
12/31/41	Transamerica Corporation	639,300	498,894
	Trans. Sub. Companies	260,520	1,950
12/31/42	Transamerica Corporation	492,528	423,374
	Trans. Sub. Companies	199,866	1,800
12/31/43	Transamerica Corporation	400,612	368,470
	Trans. Sub. Companies	169,522	2,164

(b) During the years 1941 to 1943, inclusive, the capital stock of the Bank of America N. T. & S. A. consisted of $20 par value preferred stock and $12.50 par value common stock and the total number of shares outstanding at the end of each of the years 1941 to 1943 was as follows:

	1941	1942	1943
Common—Shares	4,000,000	4,000,000	4,000,000
Preferred—Shares	540,000	460,796	405,146

Each share of both classes had equal voting power.

(c) On the dates indicated, Transamerica Corporation had outstanding shares of its $2 par value common capital stock, as follows:

Date	No. of Shares
12/31/41	10,281,100
12/31/42	10,090,000
12/31/43	9,982,000

(d) On the dates indicated, the Bank of America N. T. & S. A. owned shares of Transamerica Corporation capital stock as follows:

Date	No. of Shares
12/31/41	none
12/31/42	3,624
12/31/43	none

11. The directors and officers of the Bank during

1943 are listed in the schedule attached hereto as Exhibit 16-P.

12. It is agreed that in addition to the adjustments set forth in the deficiency notice and not contested herein, the net income for 1943 may be increased by the further amount of $73,063.27, in accordance with Respondent's Amendment to the Answer.

13. In addition to the income taxes assessed and paid for the year 1943 as shown by the pleadings, the Petitioner made payments to the Collector of Internal Revenue on February 21, 1947, on account of taxes for the year 1943 as follows:

Income Tax	$ 915,040.93
Declared Value Excess Profits Taxes	161,650.70
Total	$1,076,691.63

Signed at San Francisco, California, this 4th day of November, 1949.

/s/ GEORGE H. KOSTER,
Attorney for Petitioner.

/s/ CHARLES OLIPHANT, ECC
Chief Counsel, Bureau of Internal Revenue, Attorney for Respondent.

Filed T. C. U. S. November 7, 1949.

The Tax Court of the United States
Docket No. 8993

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Monday, November 7, 1949

Met, pursuant to notice, at 5:20 o'clock p.m.

Before: Hon. Marion J. Harron, Judge.

Appearances:

GEORGE H. KOSTER,
300 Montgomery Street, Room 839,
San Francisco, California,
Appearing on behalf of the Petitioner.

EARL C. CROUTER,
(Hon. Charles Oliphant, Chief Counsel, Bureau of Internal Revenue), appearing for the Respondent.

PROCEEDINGS

The Clerk: I will call Docket 8993, Bank of America.

Please state your appearances.

Mr. Koster: George Koster, for Petitioner.

Mr. Crouter: And Earl Crouter, for Respondent.

The Court: Mr. Koster, will you proceed.

Mr. Koster: I think before I make my opening

statement, your Honor, Mr. Crouter has some amendment to the Answer to be filed. There is no objection.

The Court: The amendment to the Answer may be filed.

Mr. Crouter: Thank you very much. This is in the form of a motion for leave, and the motion has been marked "no objection," to which Mr. Koster has signed and then the amendment to the Answer is attached, and I have filed the original and several copies with the Clerk.

The Court: Mr. Baird, you may stamp the motion "granted." The Petitioner has the usual time within which to reply to that, if you wish.

Mr. Koster: There is no reply necessary, your Honor. The matter is set forth in the amendment to the Answer. It has been conceded, and will be shown in the stipulation which will be filed later.

The Court: Very well. [3*]

Opening Statement on Behalf of Petitioner

By Mr. Koster:

This case, your Honor, involves a proposed deficiency in income taxes for the calendar year 1943. The only contested issue is whether this Petitioner Bank is entitled to a deduction for a loss sustained in the sale of certain real property where a wholly-owned subsidiary of the Petitioner Bank later acquired the property by purchase from the purchaser from the Bank. There were a number of other issues raised in the Petition but they have been abandoned

*** Page numbering appearing at top of page of original Reporter's Transcript of Record.**

and, as I have just stated, the additional matter set forth in the Respondent's amendment to the Answer has been conceded by a provision in the stipulation to that effect. The stipulation will be filed after the conclusion of the statements.

The facts about the contested issue are these: Prior to 1940 the Comptroller of the Currency of the United States made a demand upon the Bank of America to charge off a part of its investment in banking premises. The Petitioner, Bank of America, operates about 500 branch banks throughout the State of California and most of these branches perform a banking business in premises which are owned by the bank.

Now, the bank resisted the demand of the Comptroller, contending, first, that it had a right to carry its banking premises on its books at cost less depreciation; second, that the Comptroller had no legal authority to require the bank to [4] charge off part of its banking premises investment account; and, thirdly, that in any event its total investment in banking premises as shown on its books was less than the market value of the banking premises at that time. In order to establish that third contention, the bank did proceed to have its banking premises appraised by the American Appraisal Company.

After considerable negotiation the controversy with the Comptroller was settled. Under the settlement the bank agreed to make a charge off of around $3,000,000 of its account, its investment in banking premises, with the understanding, however, that it would effect the charge off in a manner which would

be consistent with the position which it had maintained throughout the controversy. In other words, the bank wanted to make this write off, or charge off, in such way that it would not be conceding the authority of the Comptroller of Currency to order a write off and in such way that the write off would not be a precedent for possible similar action in the future.

So, in carrying out the agreement, the settlement, the bank sold certain of these banking premises to Capital Company. Capital Company is a non-affiliated company engaged in the real estate business. Capital Company paid the purchase price, which incidentally was the price at which the particular properties were appraised by the American Appraisal Company. They paid the price in cash. All other formalities [5] that are usual in a purchase and sale transaction were carried out. The Bank leased the properties back from Capital Company during the period of time that Capital Company held them and the Bank paid a rental for the use of the property under the terms of the lease.

About 30 days or so after Capital Company acquired the property, it sold the property to the Merchants National Realty Corporation, which is a wholly-owned subsidiary of the Bank. The Merchants National Realty paid the same price for the property that Capital Company had paid for it.

Now, when the Bank was contemplating the sale to Capital Company, the Bank was advised by its counsel that the transaction might involve a large loss, which might be deductible for income tax pur-

poses. The Bank thereupon instructed its counsel to make a disclosure of the transaction on the return so that the Internal Revenue Bureau would be fully informed of the fact that the transaction took place, and the Court will observe that there is attached to the 1943 return as well as some prior year returns information which calls attention to the transaction.

I might add here that as part of the settlement of the controversy the Bank agreed to take these losses over a period of years, so that these losses occur in the years 1941, 1942, and 1943. However, the years 1941 and 1942 are open under refund claims. They were not prosecuted by petition to [6] the Tax Court and the year 1943 is the year which is involved in this particular proceeding.

When the Bank made the sales to Capital Company, it took the difference between its book cost and the price at which it sold the properties to Capital Company as a loss, and that constituted the charge off which met the requirements of the Comptroller of the Currency. The Commissioner of Internal Revenue, the Respondent, has disallowed the loss which was shown on the return and computed in that manner; that is, the difference between the selling price to Capital Company and the net cost to the Bank was taken as a loss deduction.

The parties to the proceeding are in accord with respect to all of the factors that enter into the computation of gain or loss, so that if the Court should determine that these transactions are transactions which must be recognized for tax purposes, then this difference between the cost or this excess of the cost

over the selling price can be determined and can be given effect in a Rule 50 computation. There is no dispute with respect to those factors.

The Court: Now, what is the amount of the loss that was claimed and which was disallowed?

Mr. Koster: The amount of the loss which was claimed is shown in an exhibit which is referred to as Exhibit 8-H, attached to the stipulation of facts which will be presented, and is in the amount of $464,811.68. That was the [7] amount of the loss which was taken on the books and was shown on the tax return and which has been disallowed as shown by the deficiency notice.

The Court: I didn't quite follow your last statement before I asked this question. You say that something can be worked out under Rule 50. As I understand it, the issue is whether the taxpayer is entitled to a loss in 1943 in the amount of $464,811.68 or is not.

Mr. Koster: I wouldn't put it that way, your Honor. The issue is whether or not, assuming that in any event the cost exceeded the selling price, whether this petitioner is entitled to a deduction for the loss sustained in the transaction.

I might say that there have been some cases which this taxpayer has prosecuted with respect to depreciation rates on these properties. Those cases have recently been concluded and the effect of those cases will be shown in the computation of the correct cost, but there will be in any event an excess of cost over selling price.

The Court: Where have those cases been? In the Tax Court or in some other court?

Mr. Koster: They were carried through the District Court to the United States Supreme Court.

The Court: I am interested in that. Do you have the citation? [8]

Mr. Koster: It is Bank of America National Trust and Savings Association vs. United States. My recollection is that the Circuit Court of Appeals decision was 167 Federal 2nd.

The Court: And when did the Supreme Court decide the case? In 1949?

Mr. Koster: The Supreme Court decided the case in the last term, 1948, by denial of certiorari.

The Court: Oh, certiorari was denied by the Supreme Court?

Mr. Koster: Yes. I think it was in the early part of 1949, in that term.

The Court: And that term was before the Ninth Circuit Court out here?

Mr. Koster: Yes.

The Court: And the Ninth Circuit held what?

Mr. Koster: The case was contested on—I don't know whether the Court recalls the Virginia Hotel Corporation case, in which the question was whether the basis should be reduced by a basis of depreciation taken in earlier years, taking the cost of depreciation in later years. We, in effect, relitigated that and got the same answer the Virginia Hotel Corporation did, so it did change the rates. But there is no dispute and, in any event, the net cost will still

exceed the selling price at which the properties were sold. [9]

The Court: If I may summarize that, just to check on my own understanding of it, if it should be held in this case that the taxpayer is entitled to a loss in 1943 on account of these transactions, then the amount of the loss may have to be recomputed under Rule 50 because the basis might have to be adjusted to take care of depreciation?

Mr. Koster: That is correct, your Honor, and there is no dispute between the parties about that adjustment.

The Court: All right, then. Thank you for clearing that up. Have you concluded your opening statement?

Mr. Koster: I have.

The Court: Will you proceed then, Mr. Crouter.

Opening Statement on Behalf of Respondent

By Mr. Crouter:

If the Court please, I believe the salient points in the case have been referred to by Mr. Koster and I would merely like to point out one or two things here. This proceeding, of course, relates only to the year 1943 and the Court probably has noticed that schedule which is marked Exhibit 8-H of the stipulation.

Mr. Koster: The Court hasn't had it yet.

Mr. Crouter: I am sorry about that. With counsel's permission, I would like to show that to the Court, because it does summarize the eight transactions involved in the year 1943 about which the

whole case really turns. [10]

Now, the only contested issue arises under Paragraph 4-A of the Petition, and that alleges the Commissioner erred in disallowing a loss in the amount of $464,811.68, sustained by the Petitioner during the year 1943. The Court will observe that that is the same money figure in the last money column in that Exhibit 8-H and that is the summary value of the losses alleged to have been sustained by the Petitioner on the disposition of all of these eight properties.

Now, the parties have stipulated that all of these properties listed, such as Oakland Main and Sacramento Main and so forth, were, as indicated by the figures, substantial banking premises of the Petitioner, Bank of America. By that it is clearly shown, I believe, that they were properties, real estate and buildings, where there were very active banking affairs and business carried on by Petitioner.

This schedule will show that the property during the calendar year 1943 on the date indicated at the extreme right—let's trace one through, such as Sacramento Main. On June 6, 1943, there was a deed executed by the Bank to Capital Company. Then on July 29, 1943, approximately a month later, there was another deed executed by Capital Company over to Merchants.

Now, the 1943 return of Merchants, referred to as such—it is the Merchants National Realty Corporation, a complete one hundred per cent subsidiary of our taxpayer, the [11] Bank of America—the return on Merchants will show that it was operated

chiefly to hold the real estate properties of the Bank. That return will show that that corporation held in excess of $14,000,000 worth of properties designated "bank premises" at the end of 1943, and the Commissioner's position is, as stated in his deficiency notice and as maintained throughout the case, that no deductible loss was sustained by the Petitioner in connection with these transactions, which for lack of a shorter and better term have sometimes been referred to as "three-cornered" transactions.

I believe I should also explain, and the stipulation makes it clear by stockholdings and percentages, that this also involves the Transamerica Corporation. That, of course, is the top corporation which owned and controlled many other corporations in connection with the Bank of America banking affairs and other matters, but there is not 50% or more of legal control by Transamerica. The Capital Company, to which the deeds went from our taxpayer, was a complete one hundred per cent subsidiary of Transamerica but the stipulated facts here show, I believe, and I want Mr. Koster to correct me if I err in any figure here, because I don't intend to mislead the Court—I believe during our year 1943 Transamerica owned between 21 and 22 per cent of the total preferred and common stock of the Bank; that is, Bank of America. So that Transamerica, whether it had actual control through that stock [12] ownership I don't believe it too material here. It didn't have legal control. On the other hand, our taxpayer, Bank of America, and referred

to in this stipulation as "the Bank" had one hundred per cent control of this Merchants Realty Corporation.

So we have transfers, and all of the transfers involved in our taxable year 1943, as shown by this Exhibit 8-H, are deeds from the Bank to Capital Company for a period of about 30 days, sometimes one day less, sometimes one day more, then deeds of the identical properties at the identical values from Capital Company back to Merchants. So that the Commissioner's position is that by these transactions the Bank really has not sustained any loss. The Bank still owned the property on the conclusion of these transactions and it is stipulated that the Bank never discontinued its banking business on those premises, it never intended to discontinue or change or transfer its banking business in those locations. Our stipulation goes even further, if the Court please, and in Paragraph 5, Subparagraph 5 of Paragraph 5, of the stipulation it is stipulated and agreed that there was an agreement between the Capital Company through its President, E. C. Wood, and the Bank, our Petitioner, through its Vice President, Mr. R. G. Smith.

Now, this was an oral agreement. It was not in writing but it has been spelled out what was understood and [13] agreed upon between the two corporations prior to the execution of these deeds, or in connection with them. It reads: Prior to the transactions described—and that means the execution of any of these deeds—the deeds would be executed as Mr. Koster has stated. Near the bottom of Paragraph 5, a part of that agreement, was

"that the Bank intended to and would receive back deeds to the said property within 30 days or so after delivery of deeds thereto to Capital Company, and Capital Company agreed to execute and deliver deeds to said property to the Bank or Merchants at any time upon request of the Bank;" and then there is some further provisions. I do not attempt to read all of that, but that is the provision there, relating to the understanding and agreement.

So that the Respondent's position is that this series of transactions was somewhat in the nature of the so-called accommodation purchases and sales of securities and stocks. Now, the Court undoubtedly has already noticed that——

The Court: You think this is a Gregory versus Helvering case, too?

Mr. Crouter: I believe the principle applies there, too.

The court will notice that these are not securities; so, as I view the case, I don't believe we have any direct application of the provisions of Section 118 of the Revenue [14] Code, where you have a thirty-day provision mentioned and certain principles set down. This involves deeds to real estate, so that the tax question comes up merely as a loss sustained on the transactions. The Respondent will contend that all of the transactions must be considered together, because they are all part of a large overall plan between these various corporations, and the exhibits in evidence will clearly show that they are related corporations in this great banking enterprise which has done a great deal in the West. Nothing of a

policy matter is involved, but the tax question does come up and is presented to the Court as to whether these transactions are at armslength or whether they are for business purposes and whether they shall be recognized, and Respondent will argue that in the economic sense, in the real sense here, this taxpayer has never lost these properties. It has not sustained any loss as required in the tax cases. It is a controlled transaction and series of transactions between these corporations.

In that connection I want to say that counsel for the Petitioner and the Petitioner's various officers have been free and above board in disclosing facts and cooperating with the Government and furnishing to the Government everything that we can conceive of that would have a bearing on the case, and if we have erred in connection with the stipulation, it is probably in including too much. [15]

I should also say that there is no question of penalty involved here. It is just a straight deduction question, so that the question of disclosure is somewhat immaterial. The claim was made for the deductions on all of the returns filed by the Petitioner and the prior years, of course, are not directly involved. Those are the years 1941 and 1942.

However, the stipulated facts do show some of the similar transactions in 1941 and 1942, and Respondent will contend on brief that this whole pattern must be considered together to show how the transactions were carried out, mostly between these three corporations. Sometimes the original deed would be by our Petitioner Bank, and sometimes we will have

the reverse of this: We will have the Merchants deeding to Capital, and then Capital back to our taxpayer. Respondent will contend that it really doesn't make too much difference as far as the ownership of depreciable bank premises is concerned, as Respondent sees it, whether the Bank itself owns the property and has the deeds in its name.

The record along that line will show that the Bank did own some $25,000,000 worth of banking property. The annual reports are included, and they will show total figures on that but they also show that Merchants, as I have stated, owned 13 or 14 million dollars worth of banking property.

The Court: May I interrupt you there. Is a [16] consolidated return filed for Merchants and Bank of America?

Mr. Crouter: No. They are separate returns.

The Court: Well, the Merchants would take the depreciation on bank property that it held, and the Bank would take depreciation on property which it held. It would make some difference to that extent, then, who owns title to the property.

Mr. Crouter: Except in this sense, that, as shown by the stipulated facts, there was a rental formula between Merchants and the Bank, based upon the income of Merchants and all the deductions which would be allowed and recognized under the Federal Law as deductions to Merchants. So that governed the amount of rental which the Bank had to pay to Merchants. So in that way I presume that the deduction factor and all of those things entered into

the picture and there was a squaring of accounts between the corporations.

But the facts will show that this subsidiary and the Bank did not deal at arm's length. It shows that they had the same office, I presume. They had the same address, 300 Montgomery Street. The subsidiary, Merchants, had no salaried officers of its own. Its affairs were carried out apparently chiefly by the officers and employees of the Bank.

Now as to the depreciation question, I want to make it clear that the Commissioner has allowed depreciation on these banking properties under the old basis without recognizing [17] the so-called sales and any adjusted new basis. So that the Commissioner has been consistent in giving them their recovery of property through the depreciation allowances on the old basis.

Now, on that score, of course, if the Court should hold that the transaction should be recognized and losses were sustained, why that, as we see it, would automatically establish and sustain a newer depreciation basis, which would be less than the Commissioner has recognized, so that it would be necessary to have smaller amounts allowed as depreciation deductions. That, I take it, though, could all be handled and disposed of under Rule 50 computations, once our main questions are decided.

Now, with that, and I have probably been too long, I don't believe I have anything else to say except that our exhibits have been tied into our stipulated facts and they include the annual reports of the Bank and also one annual report of Transamerica,

which have some bearing on the facts, down through the Joint Exhibits Nos. 20-T. Thank you.

Mr. Koster: May I make just one comment, your Honor?

The Court: May I ask a question before you proceed, Mr. Koster?

Mr. Koster: Yes.

The Court: I didn't listen carefully enough to part [18] of the statement, and so I didn't catch the explanation of what the Capital Company was. Is that an outside corporation, or is it in the Bank of America family?

Mr. Koster: No. I will just give you a little background, your Honor. Up to 1937 Transamerica Corporation owned all of the stock of the bank. It also owned and has continued to own right up to this date all of the capital stock of Capital Company. In 1937 Transamerica started a movement to reduce its holdings of bank stock. It first distributed 52% of it to its stockholders, some 120,000 stockholders, and it later made sales and other dispositions, so that by the year 1941, '42, and '43, the years we are talking about here, Transamerica owned about 22% of the stock of the bank and it has since divested itself of more stock so that it only owns about 11%. It has been getting rid of its holdings of that company through pressure from the Government principally.

The Court: You mean Bank of America?

Mr. Koster: Bank of America.

The Court: Well, what is Capital Company? Is it in the banking business or is it a real estate business or a holding company?

Mr. Koster: It is a real estate company, a substantial, large real estate company.

The Court: It wasn't organized just to [19] hold bank premises?

Mr. Koster: No. It has been engaged in the real estate business in California for years.

The Court: Shall we assume that the bank owned quite a lot of property, that is——

Mr. Koster: Capital Company.

The Court: Well, all of Capital Company's stock is owned by Transamerica?

Mr. Koster: That is correct.

The Court: So that Capital Company is in the, shall we say, Giannini banking structure and is engaged in the real estate business in general?

Mr. Koster: That is right.

The Court: This is just a loose summary just to give the Court some idea of what Capital Company is.

Mr. Koster: That is right. Incidentally, the annual report which we will submit here as one of the statements, one of the exhibits in evidence, shows that Capital Company has total assets in 1943 of some $37,000,000.

The Court: The detail isn't material here.

Mr. Koster: I wish to mention this, in talking about the Giannini interests: Ever since 1937 the Giannini interests of Transamerica have contended that they have not had control of the bank and, as I have told you, their stock interest has dwindled down until it was 22% and it is now only [20] 11%, and it has continued to represent that it has been

disposing of that interest and it does not control the bank. But, in any event, for our purpose here we didn't think that it was material enough other than to show the stock ownership.

The Court: Well, I shall not be much concerned with that. I just wanted to get some idea of what Capital Company was.

Mr. Koster: Yes.

The Court: Now I believe there is something else you wanted to say, Mr. Koster?

Mr. Koster: Yes, your Honor. You mentioned the Gregory case. We feel pretty free and easy about presenting this case here, because we are not worried about one of those cases where you perform a transaction entirely or solely for tax purposes. This transaction, as I have explained, was induced by the controversy with the Comptroller of the Currency.

The Court: I think I understand that. Your argument is just exactly what you said in your opening statement. I understood your opening statement.

Mr. Koster: I was under the impression that the Gregory case involved a question solely of tax purposes.

The Court: Well, I understood the Gregory case, because there were a series of transactions according to plan and with short intervals in between, and the case is referred to so frequently in general that I just asked Mr. [21] Crouter if he was going to refer to it, that is all.

Mr. Crouter: May I say one thing further along that line, that the Respondent will contend here, if the Court please, that it was not necessary or in ac-

cordance with a request or any direction of the Comptroller of the Currency, that these transactions have all been carried out in this way. And our Exhibit 20-T, which will be offered, will show to the Court that before these transactions were carried out, the question of how best to handle them from the tax standpoint was very carefully considered by the bank and its officers, and their tax adviser was consulted as to whether they could possibly do it in this way and establish the tax losses. So the Commissioner will argue on these facts that while it may have started with the Comptroller of the Currency and they did have the requirement to meet there, it also was done in this way to attempt to establish a lawful tax deduction. So it was sort of a double-barreled purpose or motive, particularly the motive for carrying it out in this manner.

Mr. Koster: That, we think, the Government will not be able to sustain.

The Court: Well, you will set forth your arguments in your briefs. Will you offer your stipulation now?

Mr. Koster: At this time I wish to offer a stipulation between the parties, a stipulation of facts, which has [22] attached to it and made a part of the stipulation Exhibits from 1-A to 16-P, and then there are also additional exhibits which were not attached and they were not referred to in the stipulation.

The Court: Just hold that a moment, please. The stipulation is received and made a part of the rec-

ord and the exhibits attached to the stipulation, Exhibits 1-A to 16-P, are received in evidence.

(Whereupon the documents were marked for identification as Joint Exhibits 1-A to 16-P, inclusive, and were received in evidence.)

JOINT EXHIBIT 1-A

March 11, 1941.

Messrs. William P. Funston, Supervising Examiner, Federal Deposit Insurance Corporation;

R. B. West, Vice President, Federal Reserve Bank of San Francisco; and

Irwin D. Wright, Chief National Bank Examiner,

San Francisco, California.

Gentlemen:

As you know, we have maintained that our asset values for bank premises should be our acquisition cost plus capital additions less depreciation allowance for ordinary wear and obsolescence from the date of acquisition. We have consistently maintained that the over-all book value of our bank premises is proper and conservative. In this contention we believe that we have been sustained by current American Appraisal Company valuations. You also know that there has been disagreement on this question.

It is my understanding that the adjustment committee appointed pursuant to the provisions of Paragraph 5 of the Comptroller's "Requirements" of March 6, 1940, is not agreed as to the use of the

formula set forth in that paragraph. I understand further that the committee is prepared to give favorable consideration to the following plan, which will be regarded as fully satisfying Requirement 5 and will meet the basic ideas of the committee, and will at the same time be consistent with the policy we have followed.

We will agree to establish a new cost basis for the bank premises listed in Exhibit "A" hereto attached in such manner as will result in a charge of approximately $1,000,000 against our profits for the period ending June 30, 1941, and a similar charge in the third quarter of 1941. The new cost basis to be established shall be determined from the American Appraisal Company appraisal, using the lowest appraisal of the American Appraisal Company as to the particular properties involved. No adjustment will be made as to properties with respect to which American Appraisal Company's most adverse appraisal exceeds book value.

Please advise us if this plan has the approval of the committee and is acceptable as meeting all of the requirements of Paragraph 5 of the Comptroller's "Requirements" dated March 6, 1940, so that we may proceed without delay to carry out the contemplated program.

Yours very truly,

R. G. SMITH,

Executive Vice President.

Admitted November 7, 1949.

JOINT EXHIBIT 2-B

Treasury Department
Comptroller of the Currency

June 16th, 1941.

Mr. Russell G. Smith
Executive Vice President
Bank of America National Trust
and Savings Association,

San Francisco, California.

Dear Mr. Smith:

In connection with Paragraph 5 of "Requirements of the Comptroller of the Currency" dated March 6, 1940, I am in receipt of a communication from the office indicating the Comptroller's willingness to accept the recent recommendation of the Committee that the write-off of $2,000,000 this year and approximately $2,000,000 in 1942 be accepted as satisfying the said requirement. It is to be understood, of course, that normal depreciation upon bank buildings will continue.

Any or all of the amount may be charged to Undivided Profits instead of the Unallocated Reserve if desired, the amount of that Reserve, however, not to be reduced below $4,000,000 except after write-off of the $2,000,000 in 1941 and approximately $2,000,000 in 1942. In order to bring this matter to final conclusion, I desire to have confirmation in writing from Mr. L. M. Giannini or some other qual-

ified officer of the bank, agreeing to the disposition of the second approximate $2,000,000.

Very truly yours,

/s/ IRWIN D. WRIGHT,
Chief National Bank Examiner, Twelfth Federal Reserve District.

IDW:K

Admitted November 7, 1949.

JOINT EXHIBIT 3-C

June 17, 1941

Mr. Irwin D. Wright,
Chief National Bank Examiner,
Twelfth Federal Reserve District,
No. 1 Montgomery Street,

San Francisco, California.

Dear Mr. Wright:

We have received your letter of June 16 advising us that you have received a communication from the Comptroller of the Currency indicating his willingness to accept the recent recommendation of the committee appointed under paragraph 5 of the "Requirements of the Comptroller of the Currency" dated March 6, 1940, that the reduction of the cost basis and book value of our banking premises of $2,000,000 in 1941 and approximately $2,000,000 in 1942 would be accepted as satisfying Paragraph 5 of the "Requirements."

In our letter of March 11, 1941, addressed to you and other members of the committee, we agree to

establish a new cost basis for the bank premises which would result in a decrease of $2,000,000 in the book values.

In accordance with our letter of March 11, we have already effected a reduction of $1,000,000 and will effect a similar reduction in the second half of this year. In compliance with your current request, we now agree to reduce our costs in 1942 by the additional amount of approximately $2,000,000.

The new cost basis will be determined from the American Appraisal Company's appraisals, using the lowest appraisal for each property. We are not at this time requesting any adjustment with respect to the investments in land and buildings which the American Appraisal Company appraised in excess of book value, which properties the appraisal company valued at $4,700,000 above book value.

We observe your comments regarding the handling of the unallocated reserve and understand that on conclusion of these arrangements the amount of the reserve may be reduced to $4,000,000 and subsequently reduced by the amount of reduction in book value of banking premises effected under the terms of this letter and our previous communication of March 11, 1941.

Yours very truly,

R. G. SMITH,

Executive Vice President.

Extra Copy to Mr. Wright.

Copy to Mr. L. M. Giannini.

Admitted November 7, 1949.

JOINT EXHIBIT 4-D

December 9, 1941

Mr. William F. Huck,
National Bank Examiner,
#1 Montgomery Street,
San Francisco, California.

Dear Mr. Huck:

In your Report of Examination of this Bank, commenced on August 8th, you commented as follows with respect to banking premises:

> "In view of the excessive book values of a number of properties carried, book values are to be reduced by periodical charge-offs of at least $2,000,000 per annum in addition to the regular depreciation taken. This program is to be continued until respective book values of all have been reduced to sound values."

Your comment does not correctly interpret the agreement with the Comptroller of the Currency, with which you are familiar, but causes it to appear indefinite whereas in fact it was definite and specific. You will remember that the agreement was made after detailed consideration of the matter by the special committee appointed in accordance with the "Requirements of the Comptroller of the Currency" and after extended negotiations. You will also remember that the conclusions were accepted by all parties in an effort to compose a difference of opinion.

We maintained then and still maintain that our

carrying value of bank premises should be our acquisition cost plus capital additions less depreciation. We consistently maintained, and continue to maintain, that the actual value of our bank premises greatly exceeds the book value. Our contention in this regard was confirmed by the appraisals of the American Appraisal Company.

I am enclosing copies of the correspondence exchanged between this Bank, the committee appointed by the Comptroller, and the Chief National Bank Examiner of the Twelfth District. You will observe that the final agreement approved by the Comptroller of the Currency was that we would establish a new cost basis for certain banking premises which would result in a reduction of approximately $4,000,000 in the book values. The new cost basis was to be determined from the American Appraisal Company's appraisals, using the lowest appraisal for each property but without claiming any credit for the excess of $4,700,000 in properties which the American Appraisal Company appraised above book values.

As you know, during the current year we reduced the book values of banking premises by $2,000,000 in accordance with the above-mentioned agreement. This has been in addition to normal depreciation. We are also prepared fully to carry out the provisions of the agreement. Manifestly it is not unreasonable to expect that your Examination Report would take cognizance of the provisions of the agree-

ment approved by the Comptroller of the Currency.

Cordially yours,

R. G. SMITH,
Executive Vice President.

Copies to: Mr. W. P. Folger,
Chief National Bank Examiner,
Room 230½,
Treasury Building,
Office of the Comptroller of the Currency,
Washington, D. C.
Mr. Irwin D. Wright,
Chief National Bank Examiner,
1 Montgomery St., Room 925,
San Francisco, Calif.

Admitted November 7, 1949.

JOINT EXHIBIT 5-E

March 20, 1942

Mr. Irwin D. Wright,
Chief National Bank Examiner,
#1 Montgomery Street, Room #921,
San Francisco, California.

Dear Mr. Wright:

This is in further reference to our exchange of correspondence in June of last year, particularly your letter of June 16, 1941, and our response of June 17, 1941. This correspondence related to the adjustment of the book values of certain of our

banking premises and our agreement to reduce book costs by an aggregate of $4,000,000.

As explained to you the other day, the Bureau of Internal Revenue has made an examination of the Bank's tax returns and depreciation schedules for the years 1936 to 1940, inclusive, and has revised the Bank's depreciation schedules as claimed on tax returns. After the revenue agent's adjustments are made the cost, less depreciation, on the books of the Bank, as of December 31, 1940, will be approximately $413,000, in excess of the cost, less depreciation, on the tax returns.

We now propose to reduce the book value of banking premises so that the depreciated cost as appearing on our books will be the same as the tax return schedules. When the 1940 figures are adjusted to December 31, 1941, the total amount of adjustment will result in a reduction in book values of approximately $350,000.

This will also confirm our proposal to effect a reduction of the cost of our new Head Office Building at 300 Montgomery Street. As explained to you the construction costs have now been paid and the investment will now be set up in the proper accounts of building, furniture, fixtures and safe deposit equipment. In setting up these costs, we propose to write off a substantial portion of the building cost by a charge to expense.

We should appreciate it if you would confirm our understanding that the above adjustments will be regarded as a further compliance with the Requirements of the Comptroller, with respect to the carrying value of bank premises and that such adjust-

ments may be charged to the balance of Unallocated Reserve or Undivided Profits as we may elect.

Yours very truly,

R. G. SMITH,

Executive Vice President.

Admitted November 7, 1949.

JOINT EXHIBIT 6-F

Treasury Department
Comptroller of the Currency

April 11, 1942.

Mr. R. G. Smith,
Executive Vice President,
Bank of America N. T. & S. A.,
300 Montgomery Street,
San Francisco, California.

Dear Mr. Smith:

This is in response to your letter dated March 20, 1942, asking approval of certain contemplated adjustments in the book values of banking houses as constituting further partial compliance with the requirement that book value of your banking premises be reduced by $4,000,000.

We have never conceded, and do not now concede, that this department is any anywise bound by the principles followed by the Internal Revenue Department. On the contrary, it seems to me that the desires of the two departments are unavoidably in direct opposition. Nonetheless, reduction of the book

value of certain of your buildings to bring them into line with cost-less-depreciation figures of lower amount established by the Internal Revenue Department, appears to be an entirely worthy undertaking; the sum of approximately $350,000. charged off for this purpose is accordingly approved as applying toward satisfaction of the Comptroller's requirements.

With regard to the adjustment which you contemplate making in the book value of your new Head Office building, I am unable to make a commitment without qualification. There were undoubtedly a number of sizable disbursements made in connection with this project which in my opinion should not be capitalized, for the reason that they represented neither actual cost of new construction nor tangible addition to value of the old portion of the building. Assuming that no such disbursements have been capitalized, then any charge-offs made against book value would be allowable. On the other hand, I cannot approve, as partial compliance with requirements, charge-offs whose effect is merely to eliminate items which never (in my opinion, unaffected by Internal Revenue rules) should have been capitalized.

In this connection, a simple method of circumventing debate occurs to me. A reduction of $1,000,000.00 in the book value of the land upon which your Head Office is located would be entirely acceptable to me, and would eliminate from the current discussion the

question of the propriety of capitalizing expenses of the nature described above.

Very truly yours,

/s/ IRWIN D. WRIGHT,
Chief National Bank Examiner, Twelfth Federal Reserve District.

IDW:A

Admitted November 7, 1949.

JOINT EXHIBIT 7-G

This Indenture of Lease, dated this first day of August, 1936, by and between Merchants National Realty Corporation, herein called the Lessor, and Bank of America National Trust and Savings Association, a national banking association, with its office and principal place of business in the City and County of San Francisco, State of California, herein called the Lessee,

Witnesseth:

The Lessor leases, demises and rents to the Lessee, and the Lessee taken and hires of and from the Lessor, all those certain parcels of real property situate, lying and being in the State of California, and more particularly hereinafter described, all of which said parcels are now being used by the Lessee as its banking premises at the locations hereinafter designated. The said parcels are more particularly described as follows, to wit:

(Description of properties.)

To Have and to Hold the above-described premises, with the rights, privileges, easements and appurtenances thereunto belonging and appertaining, for a period of ten (10) years, commencing on the first day of August, 1936, and ending at midnight on the 31st day of July, 1946, the Lessee yielding and paying the rental therefor and observing the obligations hereof on the Lessee's part to be kept and performed as hereinafter provided.

First: Rental. The Lessee, in consideration of the leasing of said premises as aforesaid, does hereby covenant and agree to pay the Lessor as rent for said property an amount equal to the total of all expenses and charges of the Lessor, which are allowable to the Lessor, Merchants National Realty Corporation, as deductions from gross income for Federal income tax purposes, less an amount equal to the total income of the Lessor derived from all sources other than the rental to be paid hereunder.

Second: Accrual and Payment of Rent. The rental payable under this lease shall be payable monthly on the first day of each and every month. Ten (10) days before the first day of January of each year, the Lessor shall make an estimate of the total amount of the deductions allowable to Merchants National Realty Corporation as deductions from gross income for Federal income tax purposes for the ensuing year. There shall then be deducted from said estimated amount an amount equal to the total income of the Lessor derived

from all sources other than the rental to be paid hereunder, and the monthly rent payable during said year shall be one-twelfth (1/12th) of the amount so remaining after said deduction. Said amount shall be paid monthly as rental during said year unless, during said year, the Lessor recomputes and re-estimates in like manner the amount of rental payable hereunder and notifies the said Lessee that the estimate has been changed, and after such notice the rent payable for subsequent months shall be based upon said revised computation, due allowance being made for the amount of rental theretofore paid. Within thirty (30) days after the end of each year, the Lessor shall determine from its records the amount of deductions allowable to Merchants National Realty Corporation as deductions from gross income for Federal income tax purposes, and after deducting therefrom an amount equal to the total income of the said Lessor derived from all sources other than the rental received hereunder, shall notify the said Lessee of the amount thereof, and the rental paid by the Lessee during the previous year shall be adjusted to conform to said determined amount, by the additional payment by the Lessee, to the Lessor, or by refund from the Lessor to the Lessee, as the case may be.

Third: Use of the Premises. Lessee agrees that it will not use or suffer to be used, the demised premises or any part thereof, in violation of the laws of the United States or of the State of California, or of the ordinances of any municipal or

other political subdivision in which the leased premises are situated, or the lawful orders or regulations of any governmental authority. Lessee further agrees that it will at all times keep and maintain the demised premises in like good order and condition as when received, ordinary wear and tear excepted; provided that the Lessee shall not be required to restore the said premises or any part thereof in case of such damage or destruction by fire or other cause as may render the same untenable, but under such circumstances the Lessee shall not be relieved from its obligation to pay the rent reserved hereunder. The Lessee shall pay promptly, and prior to delinquency, all charges, rates and assessments for gas, water, electricity, heat, power, telephone and any and all other utility services rendered to it in connection with its use or occupancy of the demised premises.

Fourth: Liability. The Lessee further covenants and agrees that the Lessor shall not at any time or to any extent be liable or responsible for, and that the Lessee shall and will forever indemnify and hold harmless the said Lessor from and against any and all liability and/or claims of liability on account of any injury or death of any person or persons, and on account of any loss or damage to the property in, on or about the demised premises or any portion thereof for which the Lessor as owner or otherwise, may be held liable during the term of this lease.

Fifth: Inspection of Premises. The Lessor may at any and all reasonable times enter upon the

demised premises for the purpose of inspecting the same, or of doing any work or repair or alteration or construction thereon, or of posting any notice or notices of non-responsibility, but the Lessor does not, by the execution hereof or otherwise, assume any obligation to make any repairs of any character, except that in the event the said premises, or any of them, shall be totally or partially destroyed or damaged by fire, earthquake or any other casualty against which the Lessor carries insurance, or is self-incurred by setting up reserves, then and in that event the said Lessor shall, with due diligence, repair the damage done or rebuild the premises, as the case may be.

Sixth: Default. Time is of the essence of this indenture of lease. In the case the Lessee shall make default in the payment of any installment or rent or of any other sum herein required to be paid by it, or in the observance or performance of any condition or covenant by it to be observed or performed, and such default shall continue for a period of thirty (30) days after written notice from the Lessor to make such payment or to observe or perform such condition or covenant, then the Lessor may, without further notice, terminate this lease and declare the same of no further force and effect, reenter upon said premises and remove the Lessee and all persons holding under it therefrom, using all necessary force so to do, and relet the said premises or any part thereof at such rental and upon such conditions as it may deem proper, applying the proceeds thereof, less expenses actually incurred, upon the amount due from the Lessee

hereunder, the Lessee being liable for any deficiency.

Seventh: Attorney Fees. In case any action be brought by the Lessor to enforce this lease or any provision hereof, the Lessee agrees to pay the reasonable attorney fees incurred by the Lessor in such action, the amount thereof to be fixed by the court.

Eighth: Waiver. No delay or omission of the Lessor to exercise any right or power or to take any action arising from any default on the part of the Lessee hereunder, shall be construed to be a waiver of any such default or an acquiescence therein. In case the Lessor shall have proceeded to enforce any right afforded to it by the terms hereof, and such proceedings have been discontinued or abandoned or waived, or have been determined adversely to the Lessor, then and in each such case the Lessor shall be restored to its former position and rights hereunder, and all its obligations, remedies, rights and powers shall continue as though no such proceedings had been taken.

Ninth: Condition of Property. The Lessor has examined and knows the condition of the premises hereby leased, and every part thereof, and it hereby acknowledges that said premises are in good condition and repair.

Tenth: Additions, Eliminations and Substitutions. It is agreed that from time to time the Lessor and the Lessee may add to the parcels of property covered by this lease, by agreeing that the same shall become a part of the property covered hereby.

When any such parcel is added, as herein provided, it shall become subject to all the terms and conditions of this lease, to the same extent as though it had been originally described herein. With like effect, and in the same manner, parcels now subject to this lease may be eliminated herefrom and in like manner and with like effect other parcels of property may be substituted for the parcels either now subject or hereafter to become subject to the terms of this lease.

Eleventh: Successors. This indenture of lease shall bind and inure to the benefit of the successors and assigns of the Lessor and the Lessee.

In Witness Whereof, the parties hereto have caused their corporate names to be hereunto subscribed and their corporate seals to be affixed hereto, by their proper officers thereunto duly authorized, the day and year first hereinabove written.

[Seal] MERCHANTS NATIONAL REALTY CORPORATION,
By A. S. SEARBORO,
President.
R. P. A. EVERARD,
Secretary.
BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,
By R. G. SMITH,
Vice President.
A. W. TWOMEY,
Ass't Sect.

Admitted November 7, 1949.

JOINT EXHIBIT 8-H

Bank of America N.T. and S.A.
Property Deeded by Bank to Capital Co. & by Capital Co. to M.N.R. Corp.
Years 1941 and 1943

	Property	Cost	Reserve for Depreciation	Net Cost	Check Received by Bank From Capital Co.	Revenue Stamps	Loss Shown on Bank's Books and Tax Return	Date of Execution and Delivery of Deed Bank to Cap. Co.	Date of Execution and Del. of Deed Cap. Co. to Merchants
Year 1941	Petaluma	$ 174,619.48	$ 16,408.78	$ 158,210.70	$ 95,648.00	$ 105.60	$ 62,668.30	4- 9-41	6-21-41
	Vallejo Com'l	72,140.00	3,077.09	69,062.91	55,240.00	61.05	13,883.96	4- 9-41	6-21-41
	Mountain View	73,170.60	19,911.32	53,259.28	30,957.00	34.10	22,336.38	4- 9-41	6-21-41
	Stockton M. O.	1,429,780.65	316,155.90	1,113,624.75	710,596.00	782.10	403,810.85	4- 9-41	6- 3-41
	Atwater	30,514.50	7,310.59	23,203.91	17,484.00	19.25	5,739.16	4- 9-41	6-21-41
	Glen Park	16,216.41	1,938.04	14,278.37	7,975.00	8.80	6,312.17	4- 9-41	6-21-41
	29th & Mission	95,068.31	7,917.03	87,151.28	64,393.00	70.95	22,829.23	4- 9-41	6-21-41
	8th & Vermont	177,775.80	44,728.49	133,047.31	60,795.00	....	72,252.31	4- 9-41	6-21-41
	Seventh & Westlake	230,695.96	59,991.93	170,704.03	42,356.00	....	128,348.03	4- 9-41	6-21-41
	Market-New Montg.	1,510,505.52	271,821.09	1,238,684.43	822,843.78	905.30	416,745.95	9-19-41	11- 1-41
	Hynes	25,917.65	1,486.67	24,430.98	14,218.00	15.95	10,228.93	4- 9-41	6-21-41
	Melrose (Oakland)	66,597.39	11,003.46	55,593.93	37,419.00	41.25	18,216.18	4- 9-41	6-21-41
	Elmhurst	61,859.65	7,965.85	53,893.80	39,496.00	43.45	14,441.25	4- 9-41	6-21-41
	Broadway Grand	534,000.40	82,772.88	451,227.52	344,989.64	379.50	106,617.38	9-19-41	11- 1-41
	8th & Broadway	82,798.91	5,391.43	77,407.48	30,602.00	34.10	46,839.58	4- 9-41	6-21-41
	10th & Pacific	96,456.78	3,686.45	92,770.33	61,068.00	67.65	31,769.98	4- 9-41	6-21-41
	Total 1941	$4,678,118.01	$861,567.00	$3,816,551.01	$2,436,080.42	$2,569.05	$1,383,039.64		
Year 1943	Palo Alto	$ 200,575.94	$ 41,441.37	$ 159,134.57	$ 107,788.76	$ 118.80	$ 51,464.61	5- 7-43	6- 8-43
	Fall Brook	10,561.60	1,329.30	9,232.30	7,477.09	8.25	1,763.46	5- 7-43	6- 8-43
	Sacramento Main	1,505,312.78	445,475.13	1,059,837.65	971,262.59	1,068.65	89,643.71	6-30-43	7-29-43
	Santa Maria	72,230.47	13,885.67	58,344.80	52,019.79	57.75	6,382.76	5- 7-43	6- 8-43
	Oakland Main	2,076,834.44	378,437.66	1,698,396.78	1,441,888.17	1,586.20	258,094.81	6-30-43	7-29-43
	38th & Balboa	43,075.90	9,418.55	33,657.35	30,554.28	34.10	3,137.17	5- 7-43	6- 8-43
	Mission 23rd	278,556.23	21,434.71	257,121.52	208,821.54	229.90	48,529.88	3-31-43	4-30-43
	74th & McArthur	45,047.70	5,642.65	39,405.05	33,647.17	37.40	5,795.28	5- 7-43	6- 8-43
	Total 1943	$4,232,195.06	$917,065.04	$3,315,130.02	$2,853,459.39	$3,141.05	$464,811.68		

Admitted November 7, 1949.

JOINT EXHIBIT 9-I

Merchants National Realty Corporation
Property Deeded by Merchants to Capital Co. & by Capital Co to Bank of America
Years 1941 and 1942

	Property	Cost	Reserve for Depreciation	Net Cost	Check Received by Merchants From Capital Co.	Revenue Stamps	Loss Shown on Merchant's Books and Tax Return	Date of Execution and Delivery of Deed Merch to Cap. Co.	Date of Execution and Del. of Deed Cap. Co. to B of A
Year 1941	American Ave.	$ 484,172.83	$ 21,894.98	$ 462,277.85	$163,882.20	$180.40	$298,576.05	9-15-41	11- 1-41
	Atlantic Whittier	271,994.26	36,904.55	235,089.71	184,595.36	203.50	50,697.85	9-15-41	11- 1-41
	Torrance	103,108.22	11,902.88	91,205.34	43,946.40	48.40	47,307.34	9-15-41	11- 1-41
	Western Santa Monica	288,445.21	24,672.70	263,772.51	157,153.03	173.25	106,792.73	9-15-41	11- 1-41
	Total 1941	$1,147,720.52	$ 95,375.11	$1,052,345.41	$549,576.99	$605.55	$503,373.97		
Year 1942	Chula Vista	$ 49,054.92	$ 22,825.25	$ 26,229.67	$ 13,506.74	$ 15.40	$ 12,738.33	11- 2-42	12- 3-42
	Colorado-Mentor	113,665.27	13,641.49	100,023.78	50,572.79	56.10	49,507.09	3- 2-42	5- 1-42
	Compton	122,172.92	17,824.31	104,348.61	73,337.17	80.85	31,092.29	11- 2-42	12- 3-42
	Estado-Cota	101,400.90	18,412.66	82,988.24	48,050.05	53.35	34,991.54	11- 2-42	12- 3-42
	Fullerton	205,013.45	30,429.18	174,584.27	88,643.54	97.90	86,038.63	11- 2-42	12- 3-42
	Hillcrest	75,147.98	20,674.22	54,473.76	31,635.16	35.20	22,873.80	11- 2-42	12- 3-42
	Lancaster	54,455.86	16,639.33	37,816.53	15,877.98	17.60	21,956.15	11- 2-42	12- 3-42
	Melrose-La Brea	151,956.88	18,859.94	133,096.94	70,091.23	77.55	63,083.26	11- 2-42	12- 3-42
	Seventh & Hoover	193,983.25	42,371.68	151,611.57	42,478.10	46.75	109,180.22	3- 2-42	5- 1-42
	Wilmington	75,248.23	15,739.30	59,508.93	27,406.64	30.25	32,132.54	11- 2-42	12- 3-42
	Total 1942	$1,142,099.66	$217,417.36	$924,682.30	$461,599.40	$510.95	$463,593.85		

Admitted November 7, 1949.

JOINT EXHIBIT 10-J

This Indenture of Lease, made and entered into this Seventh day of May, 1943, by and between Capital Company, a corporation, organized and existing under the laws of the State of California, hereinafter called the Lessor, and Bank of America National Trust and Savings Association, a national banking association, hereinafter called the Lessee,

Witnesseth:

That Lessor leases, demises and rents to the lessee and the lessee takes and hires of and from the lessor all that certain parcel of real property situate, lying and being in the City of Oakland, County of Alameda, State of California, and more particularly described as follows:

> Lots Numbered Six (6), Seven (7) and Eight (8) in Block Numbered Seventeen (17), as said Lots and Block are laid down, delineated and so designated upon that certain map entitled, "Electric Loop Tract, Oakland, Alameda County, California 1914," and filed in the office of the County Recorder of said County of Alameda, on the 15th day of April, 1914, in Map Book 28, at pages 65 and 66 thereof,

together with the improvements thereon.

This lease is subject to existing leases and tenancies covering portions of the above-referred-to improvements hereby demised, of which leases the lessee admits full knowledge, and the lessor does

hereby assign unto the lessee all of the right, title and interest of the lessor in and to said leases or any of them and all rentals to accrue thereunder, and any cash deposit or deposits given to secure the performance of any of said leases, and the lessee agrees that it will for and throughout the full term of this lease fulfill and perform all covenants, promises and undertakings on the part of the lessor in said leases and any of them contained, and hold the lessor herein safe and harmless from any and all liability to the lessees, all or any of them in said leases named and their respective successors and assigns by reason of any default in the performance by the lessee herein of the covenants, promises and undertakings on the part of the lessor, or its successor in interest, in any of said leases contained.

To Have and to Hold the above-described premises with the rights, privileges, easements and appurtenances thereunto belonging and appertaining, for a period of one year, commencing on 7th day of May, 1943, and ending on the 6th day of May, 1944, the lessee yielding and paying the rental therefor and reserving the obligations hereof on the lessee's part to be kept and performed as hereinafter provided.

First: Rental. The lessee, in consideration of the leasing of said premises as aforesaid, does hereby covenant and agree to pay as rental for the use and occupancy of the said premises the sum of $2,018.83 in equal installments of $168.24,

payable monthly in advance, commencing with the first day of the term hereof.

Second: Use of the premises. Lessee agrees that it will not use or suffer to be used, the demised premises or any part thereof, in violation of the laws of the United States of America, or of the State of California, or of the ordinances of any municipal or other political subdivision in which the leased premises are situated, or the lawful orders or regulations of any governmental authority. Lessee further agrees that it will at all times keep and maintain the demised premises in like good order and condition as when received, ordinary wear and tear excepted; provided that the lessee shall not be required to restore the said premises or any part thereof in case of such damage or destruction by fire or other cause as may render the same untenantable, but under such circumstances, the lessee shall not be relieved from its obligation to pay the rent reserved hereunder. The lessee shall pay promptly, and prior to delinquency, all charges, rates and assessments for gas, water, electricity, heat, power, telephone and any and all other utility services rendered to it in connection with its use or occupany of the demised premises.

Third: Liability. The lessee further covenants and agrees that the lessor shall not at any time or to any extent be liable or responsible for, and that the lessee shall and will forever indemnify and hold harmless the said lessor from and against any and all liability and/or claims of liability on account of any injury or death of any person or persons,

and on account of any loss or damage to property in, on or about the demised premises or any portion thereof for which the lessor, as owner or otherwise, may be held liable during the term of this lease.

Fourth: Inspection of Premises. The lessor may at any and all reasonable times enter upon the demised premises for the purpose of inspecting the same, or of doing any work or repair or alteration or construction thereon, or of posting any notice or notices of non-responsibility, but the lessor does not, by the execution hereof or otherwise, assume any obligation to make any repairs of any character, except that in the event the said premises, or any of them, shall be totally or partially damaged or destroyed by fire, earthquake or other casualty against which the lessor carries insurance, or is self-insured by setting up reserves, then and in that event the said lessor shall, with due diligence repair the damage done or rebuild the premises, as the case may be.

Fifth: Default. Time is of the essence of this indenture of lease. In case the lessee shall make default in the payment of any installment of rent or of any other sum herein required to be paid by it, or in the observance or performance of any condition or covenant by it to be observed or performed, and such default shall continue for a period of thirty (30) days after written notice from the lessor to make such payment or to observe or perform such condition or covenant, then the lessor may, without further notice, terminate this

lease and declare same of no further force and effect, reenter upon said premises and remove the lessee and all persons holding under it therefrom, using all necessary force so to do, and relet the said premises or any part thereof at such rental and upon such conditions as it may deem proper, applying the proceeds thereof, less expenses actually incurred, upon the amount due from the lessee hereunder, the lessee being liable for any deficiency.

Sixth: Attorney Fees. In case any action be brought by the lessor to enforce this lease or any provision hereof, the lessee agrees to pay the reasonable attorney fees incurred by the lessor in such action, the amount thereof to be fixed by the court.

Seventh: Waiver. No delay or omission of the lessor to exercise any right or power or to take any action arising from any default on the part of the lessee hereunder, shall be construed to be a waiver of any such default or an acquiescence therein. In case the lessor shall have proceeded to enforce any right afforded to it by the terms hereof, and such proceedings have been discontinued or abandoned or waived, or have been determined adversely to the lessor, then and in each such case, the lessor shall be restored to its former position and rights hereunder, and all its obligations, remedies, rights and powers shall continue as though no such proceedings had been taken.

Eighth: Condition of Property. The lessee has examined and knows the condition of the premises

hereby leased, and every part thereof, and it hereby acknowledges that said premises are in good condition and repair.

Ninth: Taxes, Assessments and Fire Insurance. The taxes and assessments levied against the demised premises have been paid through June 30, 1943, and as additional consideration for the lessor entering into this lease, the lessee agrees to pay all taxes and assessments of any kind or nature levied against the demised premises during the term hereof, commencing with the 1st instalment levied for the fiscal year 1943-44 prior to the delinquency date.

In addition to the lessee's obligation to repair as set forth in paragraph Second hereof, the lessee agrees to make any and all repairs to the demised premises that may become necessary by reason of fire damage, earthquake or other casualty.

Tenth: Personal Property Taxes. The lessee shall be liable for all taxes levied against personal property and trade fixtures placed by lessee in, on or about the herein demised premises, including but without prejudice to the generality of the foregoing, shelves, counters, vaults, vault doors, wall safes, partitions, fixtures, machinery, printing presses, plant equipment and atmospheric coolers, and if any such taxes on lessee's personal property or trade fixtures are levied against the lessor or lessor's property, and if lessor pays the same, which lessor shall have the right to do, regardless of the validity of such levy, or if the assessed value

of the lessor's premises is increased by the inclusion therein of a value placed on such property of lessee, and if lessor pays the taxes based on such increased assessment, which the lessor shall have the right to do, regardless of the validity thereof, lessee upon demand, shall, as the case may be, repay to lessor the taxes so levied against lessor, or the proportion of such taxes resulting from such increase in the assessment.

Eleventh: Successors. This indenture of lease shall bind and inure to the benefit of the successors and assigns of the lessor and the lessee.

In Witness Whereof, the parties hereto have caused their corporate names to be hereunto subscribed and their corporate seals to be affixed hereto by their respective officers thereunto duly authorized, the day and year hereinabove first written.

CAPITAL COMPANY,

By /s/ HARRY McCLELLAN,
Vice President.

By /s/ [Indistinguishable]
Secretary.

BANK OF AMERICA
NATIONAL TRUST AND
SAVINGS ASSOCIATION,

By /s/ J. RAGGIO,
Vice-President.

By /s/ R. J. VON DER MEHDEN,
Assistant Secretary.

Admitted November 7, 1949.

JOINT EXHIBIT 11-K

At a duly constituted meeting of the Board of Directors of Capital Company, held on November 13, 1941, the following resolution was adopted:

Resolved, that the actions of the officers of this Corporation in purchasing various properties from Bank of America National Trust and Savings Association and Merchants Realty Corporation, and thereafter selling such properties to Merchants National Realty Corporation or the Bank of America National Trust and Savings Association for a sum equal to the actual purchase price are hereby ratified and confirmed.

I, the undersigned Secretary of Capital Company, a California corporation, certify and declare that the foregoing is a full, true and correct copy of a resolution passed and adopted by the Board of Directors of said corporation at a Meeting thereof held on the thirteenth day of November, 1941, pursuant to the By-laws, at which meeting a quorum was present and voted in favor of said Resolution; that said resolution has not been rescinded or amended and that the same is still in full force and effect.

In Witness Whereof, I have hereunto set my hand and affixed the corporate seal of said corporation on the 12th day of July, 1949.

[Seal] /s/ [Indistinguishable],
Secretary of Capital Company.

Admitted November 7, 1949.

JOINT EXHIBIT 12-L

At a duly constituted meeting of the Board of Directors of Capital Company, held on April 16, 1942, the following resolution was adopted:

Resolved, that the action of the officers of this Corporation heretofore performed in purchasing the Premises known as the Seventh and Hoover Branch Premises of the Bank of America National Trust and Savings Association and the Colorado-Mentor Branch Premises of the Bank of America National Trust and Savings Association in the Cities of Los Angeles and Pasadena, respectively, State of California, is hereby ratified, approved and confirmed.

I, the undersigned Secretary of Capital Company, a California corporation, hereby certify and declare that the foregoing is a full, true and correct copy of a resolution duly passed and adopted by the Board of Directors of said corporation at a Meeting thereof held on the sixteenth day of April, 1942, pursuant to the By-laws, at which meeting a quorum was present and voted in favor of said Resolution; that said resolution has not been rescinded or amended and that the same is still in full force and effect.

In Witness Whereof, I have hereunto set my hand and affixed the corporate seal of said corporation on this 12th day of July, 1949.

[Seal] /s/ [Indistinguishable],
Secretary of Capital Company.

Admitted November 7, 1949.

JOINT EXHIBIT 13-M

At a duly constituted meeting of the Board of Directors of the Capital Company, held on December 10, 1942, the following resolution was adopted:

Be It Resolved, that the action of the Officers of this Corporation in purchasing eight properties from Merchants National Realty Corporation for the sum of $368,548.51 on November 2, 1942, and thereafter selling said properties for the same sum to Bank of America National Trust and Savings Association on December 3, 1942, be and it is hereby ratified and approved.

I, the undersigned Secretary of Capital Company, a California corporation, hereby certify and declare that the foregoing is a full, true and correct copy of a resolution duly passed and adopted by the Board of Directors of said Corporation at a Meeting thereof held on the tenth day of December, 1942, pursuant to the By-laws, at which meeting a quorum was present and voted in favor of said Resolution; that said resolution has not been rescinded or amended and that the same is still in full force and effect.

In Witness Whereof, I have hereunto set my hand and affixed the corporate seal of said corporation on this 12th day of July, 1949.

[Seal] /s/ [Indistinguishable],
Secretary of Capital Company.

Admitted November 7, 1949.

JOINT EXHIBIT 14-N

Copy January 10, 1941

Memorandum

Re: Banking Premises

In the last few years the Bank of America N. T. & S. A. and the Comptroller of the Currency have been engaged in a controversy concerning a number of items involving the bank. One of these items was the amount at which banking premises were carried on the books of the bank. The Comptroller of the Currency advances certain contentions that the book values were excessive and did not reflect present market values of certain of the properties. The Bank has consistently contended that it should have the right to carry its banking premises on its books as assets at the cost of acquisition, less ordinary depreciation due to wear and tear. The Bank also contended that even on the basis of market values, its book values were not excessive. In order to establish this latter point, the Bank employed the American Appraisal Company who appraised all of the properties. After that a certain agreement was reached whereby a Committee was appointed to arrive at some determination with respect to the controversy concerning banking premises. The Committee and the Bank might reach an agreement whereby the Bank is to reduce the carrying value of its banking premises by a certain amount. I believe the amount might be $2,000,000, or perhaps $3,000,000.

The Bank called me into the matter, explaining to me the controversy and asked me to advise them of a method by which they could comply with this

accord without receding from their position that they should be entitled to carry their properties at cost.

I advised them that they could probably arrange to purchase and sell properties between the Bank and Merchants National Realty Corporation, so that the purchase price of the respective properties would be a figure satisfactory to the Committee and in accordance with the agreement. The Bank officers felt that since it was a transaction between the parent and a wholly owned affiliate, the purchase and sale transaction might be ignored and the transaction considered a write-down which would establish a precedent whereby the Bank might be compelled to continue the practice of arbitrarily writing down its banking premises. The Bank, of course, did not wish to establish a precedent or to be in a position where it could ever be faced with the contention it had previously recognized the legality of any requirement by the Comptroller of Currency that banking premises should be arbitrarily written down.

I then suggested that if the Bank and Merchants National Realty Corporation should be willing to assume the risks which might result where property is removed from their hands even for a short period of time, they might arrange with some other company, such as Capital Company, to purchase the property from one and then sell to the other. Capital Company may do this as an accommodation since they have had considerable dealings with the Bank, but it would seem they might and would probably be justified in being compensated for the work involved

in the transfers of the property. Such an arrangement would avoid the element of direct transactions between affiliated companies, at least in form, even though the effect might be the same. Of course, the element of risk in transactions such as this, would be a distinction as against direct transactions between the affiliated companies.

The officers of the Bank inquired as to the results of such transactions for tax purposes and especially whether there was anything wrong in transactions such as this. I told them there is nothing in the tax law which prohibits business transactions having a definite purpose, just so long as those transactions are not used for the purpose of defrauding the Government of taxes. I also advised them that there was nothing in the taxing statutes which prohibits sales between a parent and its subsidiary or which prohibits the deduction of a loss resulting from those sales, provided the transactions were made at fair market prices, so that even if the transactions were directly between the two companies, any loss might be allowable. However, I pointed out that the disadvantage of this would be that the Bank would have lower depreciation deductions in later years, and that this would undoubtedly result in loss in tax because of increasing tax rates.

I was in doubt as to whether the Government would recognize the Capital Company as a party to the transactions because although the effect of the transactions ultimately was a transaction between affiliated companies, nevertheless Capital Company did enter into the transaction, did take title to the

property and did convey, and should be considered as part of the transaction. I am positive that if in this transaction with respect to any of the properties, a gain resulted from the sale by the Bank to Capital Company, even though later the property was resold by Capital Company to Merchants National Realty Corporation, the gain would be subject to tax. In fact, I have cases in my office where gains on sales of property between affiliated companies within the past few years have been subjected to tax.

The Bank officers have asked me that I should instruct them as to the method of carrying out these transactions for the purposes indicated, and that I should be careful that the transactions should be properly disclosed so that there could be no misunderstanding of the transactions, or so that there could be no complaint on the part of the tax authorities that these transactions were made for the purpose of defrauding the Government or were not properly disclosed. I advised them that in my opinion the handling of the transactions with an outside company would be preferable for the purposes to be accomplished and that I would see to it that the tax returns and tax files would contain the proper disclosures so that the Government would be fully informed about the transactions.

GEORGE H. KOSTER.

January 10, 1941

L.M.G. discussed this matter fully with Mr. Folger, office of Comptroller of Currency, in Washington, D. C., February, 1941.

L.M. and I discussed the matter (tax effects as well as purposes of the transactions) with Mr. Wright, Chief National Bank Examiner, San Francisco, in Washington in March, 1941, who told us that his office could not pass upon the tax effect of the transactions because that would have to be considered by the Bureau of Internal Revenue, and any acceptance by his office of the form of the transactions could not be considered a conclusion, one way or the other, on any tax problems involved in the transactions.

G.H.K.

Admitted November 7, 1949.

JOINT EXHIBIT 15-O

Merchants National Realty Corporation
List of Directors and Officers

1943

Directors

W. E. Blauer	Wm. H. Harrelson
Leon Bocqueraz	A. E. Sbarboro
F. A. Ferroggiaro	R. G. Smith
L. M. Giannini	

Officers

Chairman of the Board......	Leon Bocqueraz
President	R. G. Smith
Vice-Presidents	Marsden S. Blois
	W. J. Braunschweiger
	W. G. Cuppa
	F. A. Ferroggiaro
	J. Raggio
	C. C. Robinson
	J. H. Rosenberg
Treasurer	R. P. A. Everard
Secretary	Hugo A. Steinmeyer
Assistant Secretaries	T. G. Dempsey
	John Falconer, Jr.
	J. M. Fischer
	Edward F. Mulrooney
	I. E. Sage
	R. J. von der Mehden
	H. A. Wagstaffe

Admitted November 7, 1949.

JOINT EXHIBIT 16-P

Bank of America N. T. & S. A.

List of Directors and Administrative Officers
1943

Administrative Officers

A. P. Giannini, Chairman of the Board of Directors
L. M. Giannini (Son of A. P. Giannini), President—Chairman of the General Executive Committee
W. E. Blauer, Vice Chairman of the Board of Directors—Chairman of the General Finance Committee

A. J. Gock, Vice Chairman of the Board of Directors
F. S. Baer, Vice Chairman of the Board of Directors
C. F. Wente, Senior Vice President
F. A. Ferroggiaro, Executive Vice President—Vice Chairman of the General Finance Committee
R. G. Smith, Executive Vice President
Louis Ferrari, Vice President and Counsel
L. E. Birdzell, Vice President and Senior Trust Officer
W. J. Braunschweiger, Vice President—Chairman of the Public Relations Committee
A. Fenton, Vice President and Chairman of the Operating Committee
R. P. A. Everard, Vice President and Cashier
Otto Jeidels, Vice President—Vice Chairman of the General Finance Committee
J. A. Purdy, Vice President and Vice Chairman of the Operating Committee
Hugo A. Steinmeyer, Secretary

Directors

F. S. Baer
W. E. Blauer
Leon Bocqueraz
Dr. G. E. Caglieri
Jos. Cereghino
John A. Corotto
F. A. Ferroggiaro
A. J. Gock
A. P. Giannini
L. M. Giannini
Marshal Hale
C. N. Hawkins
John E. Marble
H. A. Mazzera
Wm. Wallace Mein
Neil Petree
Angelo Petri
Dr. Celestine J. Sullivan
E. R. Thurber
C. F. Wente
J. Zentner

Admitted November 7, 1949.

The Court: Now you may offer your other exhibits separately.

The Clerk: Do you have another copy of the stipulation?

Mr. Koster: I will send it to you. I don't have it with me.

The Court: Will you send it down here while we are in session?

Mr. Koster: Yes.

The Court: You don't have to bring it yourself. Just have someone from your office bring it down.

Mr. Koster: Yes. Mr. Kohlmeier has a case here and I may come down and listen to the trial then and bring it down. [23]

At this time I wish to introduce an exhibit in the case, Exhibit 17-Q.

The Court: Are these to be joint exhibits also?

Mr. Koster: These are all joint exhibits.

Mr. Crouter: That is correct.

The Court: Very well. So that these are agreed to by counsel and the clerk may simply mark them, is that correct?

Mr. Koster: That is correct.

The Court: Then if you will hand each exhibit to the Clerk, please, I will receive them. Just give me the numbers as you go along.

17-Q is received in evidence.

(Whereupon the document was marked for identification as Joint Exhibit 17-Q and was received in evidence.)

Mr. Koster: Exhibit 18-R.

The Court: 18-R is received in evidence.

(Whereupon the document was marked for identification as Joint Exhibit 18-R and was received in evidence.)

Mr. Koster: Exhibit 19-S.

The Court: 19-S is received in evidence.

(Whereupon the document was marked for identification as Joint Exhibit 19-S and was received in evidence.) [24]

Mr. Koster: Exhibit 20-T.

The Court: 20-T is received in evidence.

(Whereupon the document was marked for identification as Joint Exhibit 20-T and was received in evidence.)

JOINT EXHIBIT 20-T

Copy January 29, 1943

Memorandum for: Mr. F. A. Rees
National Bank Examiner
No. 1 Montgomery Street
San Francisco, California

The following reduction in the carrying value of bank premises was made in 1942:

In March, Merchants National Realty Corporation sold to Capitol Company Colorado-Mentor and Seventh & Hoover premises at their aggregate appraised value of $93,050.89. The properties were carried by

Merchants National Realty Corporation at $251,-635.35, and the sale resulted in a loss of $158,584.46. The Bank reimbursed the Corporation for this loss, charging same to Administration Losses. Subsequently, the Bank acquired these properties from Capital Company at their appraised value of $93,050.89, at which figure they are now carried on the Bank's books.

As of June 30th, the total investment in Banking Premises was carried on the Bank's books at $448,-026.73, more than the net investment as reported on the schedule of such properties for income tax purposes. This difference was brought about through application during the past ten years of a greater amount of depreciation on the income tax schedule than that actually taken on the Bank's books. On June 30th, this difference of $448,026.73 was credited to Bank Premises and charged to Unallocated Reserve, and the book value of each property reduced by the amount of difference to conform to the tax schedules.

As of October 20, Merchants National Realty Corporation's investment in Banking Premises was carried at $36,883.97 more than the net investment in these properties as reported on their income tax schedule. This difference was brought about through the application during the past ten years of a greater amount of depreciation on the tax schedule than that actually taken on the Corporation's books. On October 20, the Corporation reduced the carrying value of these properties by the amount of this difference, using therefor funds paid to it by the Bank for this

purpose. This contribution of $36,883.97 was charged to Administration Losses by the Bank.

On October 31, the sum of $1,000,000 was credited to Bank Premises and charged to Administration Losses to write-down the carrying value of San Francisco Headquarters' Premises. This investment was written down as follows: Land value $314,000. to a figure conforming with the appraisal of the American Appraisal Company, and Building Value $686,000.

On November 30, Merchants National Realty Corporation sold a number of banking premises to Capital Company at their aggregate appraised value of $368,548.51. These properties were carried by the Corporation at $673,046.95, and their sale resulted in a loss of $304,498.44. The Corporation was reimbursed for this loss and it was charged to Administration Losses on Bank's books. These properties were subsequently acquired by the Bank at their appraised value of $368,548.51, and are now so carried.

Total amount of write-down of Banking Premises, in accordance with the above, during 1942 was $1,948,503.55. This, with the adjustment made in 1941, brings the total adjustment of the banking premises made in accordance with the "Requirements of the Comptroller of the Currency" to $4,003,995.32.

R. G. SMITH.

Admitted November 7, 1949.

Mr. Koster: Exhibit 21-U.

The Court: I guess you better tell us what 20-T is.

Mr. Koster: 20-T is a letter which makes reference to these transactions.

The Court: Letter from whom to whom?

Mr. Koster: Mr. R. G. Smith, Executive Vice President of the bank, to Mr. F. A. Reese, National Bank Examiner, dated January 29, 1943, which contains, among other things, some comments about the transactions involved in this proceeding.

The Court: Yes.

Mr. Koster: Then as Exhibit 21-U the income and excess profits tax return for the Bank of America for the year 1943, together with schedules that are a part of the return.

The Court: That is received in evidence as 21-U.

(Whereupon the document was marked for identification as Joint Exhibit 21-U and was received in evidence.)

1121 att'd Computation proved

Form 1120
Treasury Department
Internal Revenue Service

UNITED STATES
CORPORATION INCOME AND DECLARED VALUE EXCESS-PROFITS TAX RETURN 1943
For Calendar Year 1943

or fiscal year beginning ...., 1943, and ending ...., 1944

File Code 41
Serial No. 410257
District 1-Calif

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION
(Name)

300 MONTGOMERY STREET
(Street and number)

SAN FRANCISCO (City or town) CALIFORNIA (State)

Kind of business: BANK 355

Business group serial number (from Instruction N) 165

RECEIVED MAR 14 1944 COLLECTOR OF INT. REV. FIRST DIST. CALIF.

RECEIVED WITH REMITTANCE COLLECTOR OF INT. REV. FIRST DIST. CALIF.

NOV 24

Cash Check M. O.
First Payment

NORMAL-TAX NET INCOME COMPUTATION

Item and Instruction No.	GROSS INCOME			
1.	Gross sales (where inventories are an income-determining factor) $........; Less: Returns and allowances $........	$		
2.	Less: Cost of goods sold. (From Schedule A)			
3.	Gross profit from sales	$		
4.	Gross receipts (where inventories are not an income-determining factor) $			
5.	Less: Cost of operations. (From Schedule B)			
6.	Gross profit where inventories are not an income-determining factor			
7.	Interest on loans, notes, mortgages, bonds, bank deposits, etc.	37,664,020	97	
8.	Interest on corporation bonds, etc. $1,210,700.94 Less: Amortizable Bond Premium $152,201.44	1,058,499	50	
9.	(a) Interest on United States savings bonds and Treasury bonds owned in excess of the principal amount of $5,000 issued prior to March 1, 1941. (From Schedule M, line 15 (a) (2) (iii)) 10,389,635.54 2,141,693.09	8,247,942	45	
	(b) Interest on Treasury notes issued on or after December 1, 1940, and obligations issued on or after March 1, 1941, by the United States or any agency or instrumentality thereof. (Submit schedule) 10,184,176.00 261,420.97	9,922,755	03	
10.	Rents	2,951,158	25	
11.	Royalties			
12.	(a) Net gain from sale or exchange of capital assets. (From Schedule C)			
	(b) Net gain (or loss) from sale or exchange of property other than capital assets. (From Schedule D)	603,792	36	
13.	Dividends. (From Schedule E)	19,898	26	
14.	Other income. (State nature)	10,769,284	03	
15.	Total income in items 3, and 6 to 14, inclusive			$70,029,766 13
	DEDUCTIONS			
16.	Compensation of officers. (From Schedule F)	$		
17.	Salaries and wages (not deducted elsewhere)	24,183,471	05	
18.	Rent	1,554,827	96	
19.	Repairs	785,223	36	
20.	Bad debts. (From Schedule G)	2,109,288	33	
21.	Interest	9,471,702	92	
22.	Taxes. (From Schedule H) (Deduct declared value excess-profits tax as item 34)	7,160,268	27	
23.	Contributions or gifts paid. (From Schedule I)	266,794	90	
24.	Losses by fire, storm, shipwreck, or other casualty, or theft. (Submit schedule)			
25.	Depreciation. (From Schedule J)	1,355,618	18	
26.	Depletion of mines, oil and gas wells, timber, etc. (Submit schedule)			
27.	Net operating loss deduction. (Submit statement)			
28.	Amortization of emergency facilities. (Submit schedule)			
29.	Other deductions authorized by law. (From Schedule K)	5,598,156	61	
30.	Total deductions in items 16 to 29, inclusive			52,485,351 58
31.	Net income for declared value excess-profits tax computation (item 15 minus item 30)			$17,544,414 55
32.	Add: Interest on obligations of certain instrumentalities of the United States issued prior to March 1, 1941. (From Schedule M, line 15 (a) (3) (ii)) $932,302.99 Less amortizable bond premiums, $336,336.44			595,966 55
33.	Total of lines 31 and 32			$18,140,381 10
34.	Less: Declared value excess-profits tax			1,815 07
35.	Net income			$18,138,566 03
36.	Less: Interest on certain obligations of the United States and its instrumentalities issued prior to March 1, 1941. (Enter total of lines 9 (a) and 32)			8,843,909 00
37.	Adjusted net income			$9,294,657 03
38.	Less: Income subject to excess profits tax. (From Form 1121)	$		
39.	Dividends received credit (85 percent of column 2, Schedule E, but not in excess of 85 percent of item 37 minus item 38, above)	16,913	52	16,913 52
40.	Normal-tax net income			$9,277,743 51
	TOTAL INCOME AND DECLARED VALUE EXCESS-PROFITS TAXES			
41.	Total income tax (line 28 or 50, page 2, whichever is applicable)	$5,126,122	84	
42.	Less: Credit for income taxes paid to a foreign country or United States possession allowed a domestic corporation			
43.	Balance of income tax			5,126,122 84
44.	Total declared value excess-profits tax (line 6, page 2)			1,815 07
45.	Total income and declared value excess-profits taxes due			$5,127,937 91

1,281,984

AFFIDAVIT. (See Instruction E)

We, the undersigned, president (or vice president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return (including any accompanying schedules and statements) has been examined by him and is, to the best of his knowledge and belief, a true, correct, and complete return, made in good faith, for the taxable year stated, pursuant to the Internal Revenue Code and the regulations issued thereunder.

Subscribed and sworn to before me this 9th day of March, 1944

Notary Public in and for the City and County of San Francisco, State of California

NOTARIAL SEAL

(Signature of officer administering oath) (Title)

My Commission Expires ...

CORPORATE SEAL

Exe. Vice President
(President or vice president, or other principal officer) (State title)

Treasurer
(Treasurer, Assistant Treasurer, or Chief Accounting Officer) (State title)

AFFIDAVIT. (See Instruction E)

I/we swear (or affirm) that I/we prepared this return for the person named herein and that the return (including any accompanying schedules and statements) is a true, correct, and complete statement of all the information respecting the tax liability of the person for whom this return has been prepared of which I/we have any knowledge.

Subscribed and sworn to before me this 9th day of March, 1944

C. O'Neill
(Signature of person preparing the return)

Notary Public in and for the City

ASSETS	Beginning of Taxable Year: Amount		Beginning of Taxable Year: Total		End of Taxable Year: Amount		End of Taxable Year: Total	
1. Cash			457,817,928	48			591,413,684	4
2. Notes and accounts receivable	$				$			
Less: Reserve for bad debts			840,487,057	53			810,415,149	8
3. Inventories (itemize in separate schedule)								
4. Investments in governmental obligations:								
(a) Obligations of a State, Territory, or political subdivision thereof, or the District of Columbia, or United States possessions	175,669,415	85			191,036,188	33		
(b) Obligations of the United States:								
(1) Obligations issued on or before September 1, 1917; all postal savings bonds; Treasury notes issued prior to December 1, 1940; and Treasury bills issued prior to March 1, 1941	11,184,246	46			5,832,140	28		
(2) United States savings bonds and Treasury bonds issued prior to March 1, 1941	385,980,251	34			512,199,454	49		
(3) Treasury notes issued on or after December 1, 1940; and all other obligations of the United States issued on or after March 1, 1941	585,433,888	75			1,253,982,871	40		
(c) Obligations of instrumentalities of the United States:								
(1) Obligations of Federal land banks, joint stock land banks, and Federal intermediate credit banks issued prior to March 1, 1941	17,025,258	48			14,379,928	09		
(2) Obligations issued by other instrumentalities of the United States prior to March 1, 1941	45,510,487	27			62,687,131	37		
(3) Obligations of all instrumentalities of the United States issued on or after March 1, 1941	2,094,124	93	1,222,897,673	08	2,329,213	21	2,042,446,927	1
5. Other investments (itemize) Schedule			51,712,795	18			64,513,838	3
6. Capital assets:								
(a) Depreciable assets (itemize in separate schedule)	$				$			
Less: Reserve for depreciation Schedule			30,076,675	17			25,734,306	2
(b) Depletable assets	$				$			
Less: Reserve for depletion								
(c) Land			5,130,296	20			2,807,133	1
7. Other assets (itemize) Schedule	$		156,945,489	65	$		152,563,426	7
8. Total Assets			$2,765,067,915	29			$3,689,894,465	8
LIABILITIES								
9. Accounts payable Deposits			$2,577,009,090	27			$3,484,265,835	2
10. Bonds, notes, and mortgages payable:								
(a) With original maturity of less than 1 year					$			
(b) With original maturity of 1 year or more								
11. Accrued expenses (itemize) Interest and Taxes			8,199,273	93	$		11,959,376	8
12. Other liabilities (itemize) Suspense	$		9,372,054	77	$		14,310,110	3
13. Surplus reserves (itemize in separate schedule) Schedule			28,120,361	99			34,205,055	6
14. Capital stock:								
(a) Preferred stock	$9,215,920	00			$8,102,920	00		
(b) Common stock	50,000,000	00	59,215,920	00	50,000,000	00	58,102,920	0
15. Paid-in or capital surplus			62,000,000	00			75,000,000	0
16. Earned surplus and undivided profits			21,151,214	33			12,051,167	6
17. Total Liabilities			$2,765,067,915	29			$3,689,894,465	8

RECEIVED MAR 14 1944 COLLECTOR OF INT. REV. FIRST DIST. CALIF.

Schedule M.—RECONCILIATION OF NET INCOME AND ANALYSIS OF EARNED SURPLUS AND UNDIVIDED PROFITS

1. Total distributions to stockholders charged to earned surplus during the taxable year:		
(a) Cash	$10,412,220	41
(b) Stock of the corporation		
(c) Other property		
2. Contributions (excess over 5 percent limitation)		
3. Federal income and excess-profits taxes	5,022,000	00
4. Income taxes claimed as a credit in whole or in part in item 42, page 1		
5. Federal taxes paid on tax-free covenant bonds		
6. Excess of capital losses over capital gains		
7. Additions to surplus reserves (list separately):		
(a) Schedule M 1	8,740,049	61
(b) Schedule M 1	650,008	76
8. Other unallowable deductions:		
(a) Over accrual taxes	151,211	62
(b)		
9. Adjustments not recorded on books (itemize):		
(a) M.K.R.Corp. Rent (net)	92,204	14
(b) Dividends - Trust Fund	2,721	75
10. Sundry debits to earned surplus (itemize):		
(a) Surplus	13,000,000	00
(b)		
11. Earned surplus and undivided profits at close of the taxable year (Schedule L)	12,051,167	67
12. Total of lines 1 to 11	50,121,583	96

13. Earned surplus and undivided profits at close of preceding taxable year (Schedule L)	$21,151,214	3
14. Adjusted net income (item 37, page 1)	9,294,657	0
Depreciation	1,864	6
15. Nontaxable and partially exempt income:		
(a) Interest on: D.C.Excess Profit Tax	1,915	07
(1) Obligations of a State, Territory, or political subdivision thereof, or the District of Columbia, or United States possessions	4,778,677	4
(2) Obligations of the United States:		
(i) Obligations issued on or before September 1, 1917; all postal savings bonds; Treasury notes issued prior to December 1, 1940; and Treasury bills issued prior to March 1, 1941	52,540	48
(ii) United States savings bonds and Treasury bonds owned in the principal amount of $5,000 or less, issued prior to March 1, 1941	212	50
(iii) United States savings bonds and Treasury bonds owned in excess of the principal amount of $5,000 issued prior to March 1, 1941	8,247,942	45
(3) Obligations of instrumentalities of the United States:		
(i) Obligations of Federal land banks, joint stock land banks, and Federal intermediate credit banks issued prior to March 1, 1941	171,905	86
(ii) Obligations issued by other instrumentalities of the United States prior to March 1, 1941	595,966	55
San Clemente Trust	15,657	00
(b) Other nontaxable income (itemize):		
(1) Recoveries 1st Naps	9,865	64
(2) Dividends - Schedule E	223,777	50
16. Charges against surplus reserves (itemize):	3,861,129	62
Schedule M 1 - A and B	13,741	58
17. Adjustments not recorded on books (itemize): Sales - Bonds & Real Estate	1,700,442	49
18. Sundry credits to earned surplus (itemize): P/L Adjustment	173	79
19. Total of lines 13 to 18	$50,121,583	96

EXCESS PROFITS TAX. (See Instructions for Form 1121)

(a) Is an excess profits tax return on Form 1121 being filed for the taxable period covered by this return? Yes

(b) If a personal service corporation (other than a member of an affiliated group of corporations filing a consolidated return) signifies below its des[ire] not to be subject to the excess profits tax, it shall be exempt from such tax and the provisions of Supplement S, Chapter 1, shall apply to t[he] shareholders in such corporation who were such shareholders on the last day of the taxable year of the corporation. (Attach Form 1121P

(c) If corporation claims exemption under section 727 of the Internal Revenue Code, state basis of claim

(d) If an excess profits tax return is not being filed for the reason that it is claimed that the excess profits net income computed under the invested capi[tal] method is not greater than $5,000, the following Schedule N should be filled in. The completion of Schedule N does not constitute the filing of [an] excess profits tax return.

Schedule N.—EXCESS PROFITS NET INCOME COMPUTATION

1. Normal-tax net income (computed without credit for income subject to excess profits tax) (item 40 plus item 38, page 1)	$	
2. Net short-term capital gain (do not enter net short-term capital loss)		
3. 50 percent of interest on borrowed capital		
4. Adjustment to net operating loss deduction under section 711 (a) (2) (L)		
5. Total of lines 1 to 4	$	

6. Dividends received credit adjustment (item 13, page 1, excluding the sum of (a) dividends received (actual or constructive) from foreign personal holding companies, and (b) dividends received on stock held primarily for sale to customers by a dealer in securities; minus item 38, page 1)	$	
7. Net gain from sale or exchange of capital assets (item 12 (a), page 1)		
8. Income from retirement or discharge of bonds, etc.		
9. Refunds and interest on Agricultural Adjustment Act taxes		
10. Recoveries of bad debts		
11. Total of lines 6 to 10	$	

12. Excess profits net income (for purpose of determining necessity for filing return) (line 5 minus line 11) $

Other Earnings—Line 14

Service Charges	$4,892,482.51	
Collection Charges	251,575.30	
Loan Fees	218,477.03	
Exchange	766,922.01	
Overs	245,457.89	
Brokerage	26,719.57	
Discounts	7,006.20	
Commissions	137,564.28	
I. C. L. Fees	407,250.85	
Trust Department Earnings	1,731,535.00	
Trustee Fees	20,075.75	
O. R. E. Income	225,574.65	
Recoveries	1,400,099.65	
Miscellaneous	438,543.34	$10,769,284.03

Gain & Losses from Sale Non Capital Assets—Line 12 b

Description	Sales Price	Cost	Expenses	Depreciation	Gain or Loss
Bonds	$1,940,490,418.12	$1,940,407,197.19			$ 83,220.93
Bank Premises	2,856,655.54	4,244,250.72	$3,141.05	$ 917,376.30	473,359.93
Other Real Estate	2,662,576.03	3,054,519.77		178,155.40	213,788.34
Auto	625.00	890.95		400.93	134.98
Total	$1,946,010,274.69	$1,947,706,858.63	$3,141.05	$1,095,932.63	$603,792.36

Bad Debts—Line 20

Loans	$1,223,787.50	
Checks	86,657.39	
Interest	63,461.97	
Losses Charged Reserves	13,741.58	
Miscellaneous	721,639.89	$2,109,288.33

Bank of America NT & SA 1943 Schedules (Cont'd)

Taxes—Line 22		
Social Security	$ 838,434.70	
Bank Examination	190,965.20	
Capital Stock	258,000.00	
Real Estate	858,938.00	
Franchise	3,121,152.81	
Trust Examination	5,758.75	
Federal Deposit Insurance	1,882,641.84	
Miscellaneous	4,376.97	$7,160,268.27
Other Deductions—Line 29		
Maintenance Contracts	$956,749.30	
Heat, Fuel, Lights, Power, Water, Supplies, Rubbish	429,557.95	
Advisory Board & Directors Fees	84,504.45	
Legal	180,098.94	
Stationery & Office Supplies	673,288.47	
Subscriptions & Reports	69,746.62	
Advertising	577,195.38	
Dues	109,879.22	
Telephone & Telegraph	481,230.70	
Postage	794,371.82	
Travel	236,344.10	
Insurance	264,399.05	
Janitor Contracts	50,578.38	
Shorts	328,698.28	
O. R. E. Expense	111,592.00	
London Branch Loss	26,294.82	
San Clemente Loss	15,657.00	
Miscellaneous	207,970.13	$5,598,156.61

Depreciation—Line 25	Cost	Depreciation Prior Years	Remaining Cost	1943 Depreciation
Bank Premises	$23,005,523.26	$ 4,071,401.07	$18,934,122.19	$ 272,697.67
Alterations—Leased B/P	1,388,977.75	801,241.99	587,735.76	123,001.15
Safe Deposit Equipment	3,599,115.17	1,016,557.16	2,582,558.01	72,010.22
Fixtures	9,726,795.64	7,042,914.51	2,683,881.13	513,721.94
Furniture	6,577,354.57	4,394,961.08	2,182,393.49	312,949.41
Addressograph Equipment	43,309.86	36,399.63	6,910.23	2,583.11
Automotive Equipment	164,506.86	84,445.34	80,061.52	26,392.58
Personal Property	3,061.93	204.13	2,857.80	204.13
Improvements—O. R. E.	770,734.47	88,153.22	682,581.25	30,632.05
Restorations	50,498.35	29,322.49	21,175.86	1,425.92
Total	$45,329,877.86	$17,565,600.62	$27,764,277.24	$1,355,618.18

Bank of America N. T. & S. A.—1943

Explanatory Statement as to Losses Included in Losses Reported in Schedule D

The Comptroller of the Currency insisted that the cost less depreciation of certain properties owned by this bank exceeded its present value and that a charge-off had to be made to reduce the cost to present value. In order to accomplish this in a manner consistent with the Bank's policy and contention that its properties should be carried at cost (less a reasonable allowance for current depreciation) it sold these properties to Capital Company. The selling price was fixed at the present value of the property and Capital Company paid the selling price in cash. At a later date Merchants National Realty Corporation, a wholly owned subsidiary of the Bank, purchased these properties from Capital Company, for cash, for the same price at which Capital Company had purchased them. The loss resulting from this sale is claimed on this return since the Income Tax statute contains no provisions exempting either gain or loss from such a transaction from being included in computing net income. Furthermore, this loss should be deductible in any event as a loss, because it was taken in compliance with a requirement of the Comptroller of the Currency.

Admitted November 7, 1949.

Mr. Koster: Exhibit 22-V being the income and excess profits tax return of the Merchants National Realty Corporation for 1943. [25]

The Court: That is received in evidence.

(Whereupon the document was marked for identification as Joint Exhibit 22-V and was received in evidence.)

Form 1120
Treasury Department
Internal Revenue Service

UNITED STATES
CORPORATION INCOME AND DECLARED VALUE EXCESS-PROFITS TAX RETURN 1943

For Calendar Year 1943

or fiscal year beginning ...., 1943, and ending ...., 1944

File Code 412
Serial No. 851648
District

RECEIVED MAR 14 1944 COLLECTOR OF INT. REV. FIRST DIST. CALIF.

Cash Check M. O.
First Payment
$

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

Merchants National Realty Corp. (Name)

300 Montgomery St. (Street and number)

San Francisco (City or town) California (State)

Kind of business: Real Estate

Business group serial number (from instruction N) 182

NORMAL-TAX NET INCOME COMPUTATION

Item and Instruction No.	GROSS INCOME		
	Gross sales (where inventories are an income-determining factor) $; Less: Returns and allowances $	$	
	Less: Cost of goods sold. (From Schedule A)		
	Gross profit from sales		
	Gross receipts (where inventories are not an income-determining factor) $		
	Less: Cost of operations. (From Schedule B)		
	Gross profit where inventories are not an income-determining factor		
	Interest on loans, notes, mortgages, bonds, bank deposits, etc.	2,714.48	
	Interest on corporation bonds, etc. $ Less: Amortizable Bond Premium $		
	(a) Interest on United States savings bonds and Treasury bonds owned in excess of the principal amount of $5,000 issued prior to March 1, 1941. (From Schedule M, line 15 (a) (2) (iii))		
	(b) Interest on Treasury notes issued on or after December 1, 1940, and obligations issued on or after March 1, 1941, by the United States or any agency or instrumentality thereof. (Submit schedule)		
	Rents	898,977.55	
	Royalties		
	(a) Net gain from sale or exchange of capital assets. (From Schedule C)		
	(b) Net gain (or loss) from sale or exchange of property other than capital assets. (From Schedule D)	80,173.38	
	Dividends. (From Schedule E)		
	Other income. (State nature) Schedule	191.56	
	Total income in items 3, and 6 to 14, inclusive		$ 982,056.97
	DEDUCTIONS		
	Compensation of officers. (From Schedule F)	$	
	Salaries and wages (not deducted elsewhere)	18,344.55	
	Rent	27,578.40	
	Repairs		
	Bad debts. (From Schedule G)		
	Interest		
	Taxes. (From Schedule H) (Deduct declared value excess-profits tax as item 34)	343,220.14	
	Contributions or gifts paid. (From Schedule I)		
	Losses by fire, storm, shipwreck, or other casualty, or theft. (Submit schedule)	2,625.63	
	Depreciation. (From Schedule J)	392,572.40	
	Depletion of mines, oil and gas wells, timber, etc. (Submit schedule)		
	Net operating loss deduction. (Submit statement)		
	Amortization of emergency facilities. (Submit schedule)		
	Other deductions authorized by law. (From Schedule K)	197,715.85	
	Total deductions in items 16 to 29, inclusive		982,056.97
	Net income for declared value excess-profits tax computation (item 15 minus item 30)		$ None
	Add: Interest on obligations of certain instrumentalities of the United States issued prior to March 1, 1941. (From Schedule M, line 15 (a) (3) (ii)) $ Less amortizable bond premiums, $		
	Total of lines 31 and 32		$
	Less: Declared value excess-profits tax		
	Net income		$
	Less: Interest on certain obligations of the United States and its instrumentalities issued prior to March 1, 1941. (Enter total of lines 9 (a) and 32)		
	Adjusted net income		$
	Less: Income subject to excess profits tax. (From Form 1121)	$	
	Dividends received credit (85 percent of column 2, Schedule E, but not in excess of 85 percent of item 37 minus item 38, above)		
	Normal-tax net income		$ None

TOTAL INCOME AND DECLARED VALUE EXCESS-PROFITS TAXES

	Total income tax (line 28 or 50, page 2, whichever is applicable)	$ None	
	Less: Credit for income taxes paid to a foreign country or United States possession allowed a domestic corporation		
	Balance of income tax		$
	Total declared value excess-profits tax (line 8, page 2)		
	Total income and declared value excess-profits taxes due		$ None

AFFIDAVIT. (See Instruction E)

We, the undersigned, president (or vice president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return (including any accompanying schedules and statements) has been examined by him and is, to the best of his knowledge and belief, a true, correct, and complete return, made in good faith, for the taxable year stated, pursuant to the Internal Revenue Code and the regulations issued thereunder.

Subscribed and sworn to before me this 9th day of March, 1944 — R. L. Smith, Pres. (President or other principal officer) (State title)

NOTARIAL SEAL — John F. Burns (Signature of officer administering oath) Notary Public in and for the City and County of San Francisco, State of California (Title) My Commission Expires April 12, 19

CORPORATE SEAL — Treas. (Treasurer, Assistant Treasurer, or Chief Accounting Officer) (State title)

AFFIDAVIT. (See Instruction E)

I/we swear (or affirm) that I/we prepared this return for the person named herein and that the return (including any accompanying schedules and statements) is a true, correct, and complete statement of all the information respecting the tax liability of the person for whom this return has been prepared of which I/we have any knowledge.

Subscribed and sworn to before me this 9th day of March, 1944 — C. H. Neill (Signature of person preparing the return)

NOTARIAL SEAL — John F. Burns (Signature of officer administering oath) Notary Public in and for the City and County of San Francisco, State of California. My Commission Expires April 12, 19

(Signature of person preparing the return)

(Name of firm or employer, if any)

Schedule L.—BALANCE SHEETS. (See Instruction L)

1142

ASSETS	Beginning of Taxable Year: Amount	Beginning of Taxable Year: Total	End of Taxable Year: Amount	End of Taxable Year: Total
1. Cash		$2,184,590.02		$290,021.58
2. Notes and accounts receivable	$21,451.94		$75,900.93	
Less: Reserve for bad debts	141.63	21,310.31	141.63	75,759.30
3. Inventories (itemize in separate schedule)				
4. Investments in governmental obligations:				
(a) Obligations of a State, Territory, or political subdivision thereof, or the District of Columbia, or United States possessions	$		$	
(b) Obligations of the United States:				
(1) Obligations issued on or before September 1, 1917; all postal savings bonds; Treasury notes issued prior to December 1, 1940; and Treasury bills issued prior to March 1, 1941				
(2) United States savings bonds and Treasury bonds issued prior to March 1, 1941				
(3) Treasury notes issued on or after December 1, 1940; and all other obligations of the United States issued on or after March 1, 1941				
(c) Obligations of instrumentalities of the United States:				
(1) Obligations of Federal land banks, joint stock land banks, and Federal intermediate credit banks issued prior to March 1, 1941				
(2) Obligations issued by other instrumentalities of the United States prior to March 1, 1941				
(3) Obligations of all instrumentalities of the United States issued on or after March 1, 1941				
5. Other investments (itemize)				
6. Capital assets:				
(a) Depreciable assets (itemize in separate schedule) Bank Premises	$13,056,458.10		$14,567,523.95	
Less: Reserve for depreciation Furniture & Fixtures	9,368.76		9,368.76	
~~(b) Depletable assets~~	$13,065,826.86		$14,576,892.71	
Less: Reserve ~~for depletion~~	3,986,444.08	9,079,382.78	4,358,789.52	10,218,103.19
(c) Land		7,931,654.39		8,615,041.37
7. Other assets (itemize)	$		$	
Prepaid Expense		11,727.92		21,815.59
8. Total Assets		$19,228,665.42		$19,220,741.03
LIABILITIES				
9. Accounts payable		$2,602.95		$5,677.91
10. Bonds, notes, and mortgages payable:				
(a) With original maturity of less than 1 year	$		$	
(b) With original maturity of 1 year or more				
11. Accrued expenses (itemize)	$		$	
Reserve for Taxes	7,217.08		6851.22	
12. Other liabilities (itemize) " " Insurance	$201,265.49		$231,100.34	
" " Rentals	14,325.12		11,411.52	
13. Surplus reserves (itemize in separate schedule)		222,807.69		249363.08
14. Capital stock:				
(a) Preferred stock	$		$	
(b) Common stock		2,000,000.00		2,000,000.00
15. Paid-in or capital surplus		16,652,495.22		16,652,495.22
16. Earned surplus and undivided profits		350,759.56		313,204.82
17. Total Liabilities		$19,228,665.42		$19,220,741.03

Schedule M.—RECONCILIATION OF NET INCOME AND ANALYSIS OF EARNED SURPLUS AND UNDIVIDED PROFITS

1. Total distributions to stockholders charged to earned surplus during the taxable year:	
(a) Cash	$
(b) Stock of the corporation	
(c) Other property	
2. Contributions (excess over 5 percent limitation)	
3. Federal income and excess-profits taxes	
4. Income taxes claimed as a credit in whole or in part in item 42, page 1	
5. Federal taxes paid on tax-free covenant bonds	
6. Excess of capital losses over capital gains	
7. Additions to surplus reserves (list separately):	
(a) Self Insurance	32,460.48
(b)	
8. Other unallowable deductions:	
(a)	
(b)	
9. Adjustments not recorded on books (itemize):	
(a) Real Estate Sales	99,924.03
(b)	
10. Sundry debits to earned surplus (itemize):	
(a) 1942 Rent Adjustment	49,584.44
(b)	
11. Earned surplus and undivided profits at close of the taxable year (Schedule L)	313,204.82
12. Total of lines 1 to 11	$495,173.77

13. Earned surplus and undivided profits at close of preceding taxable year (Schedule L)	$350,759.56
14. Adjusted net income (item 37, page 1)	
15. Nontaxable and partially exempt income:	
(a) Interest on:	
(1) Obligations of a State, Territory, or political subdivision thereof, or the District of Columbia, or United States possessions	
(2) Obligations of the United States:	
(i) Obligations issued on or before September 1, 1917; all postal savings bonds; Treasury notes issued prior to December 1, 1940; and Treasury bills issued prior to March 1, 1941	
(ii) United States savings bonds and Treasury bonds owned in the principal amount of $5,000 or less, issued prior to March 1, 1941	
(iii) United States savings bonds and Treasury bonds owned in excess of the principal amount of $5,000 issued prior to March 1, 1941	
(3) Obligations of instrumentalities of the United States:	
(i) Obligations of Federal land banks, joint stock land banks, and Federal intermediate credit banks issued prior to March 1, 1941	
(ii) Obligations issued by other instrumentalities of the United States prior to March 1, 1941	
(b) Other nontaxable income (itemize):	
(1)	
(2)	
16. Charges against surplus reserves (itemize): Self Insurance Losses	2,625.63
17. Adjustments not recorded on books (itemize): 1943 Rent Adjustment	141,788.58
18. Sundry credits to earned surplus (itemize):	
19. Total of lines 13 to 18	$495,173.77

EXCESS PROFITS TAX. (See Instructions for Form 1121)

(a) Is an excess profits tax return on Form 1121 being filed for the taxable period covered by this return? Yes

(b) If a personal service corporation (other than a member of an affiliated group of corporations filing a consolidated return) signifies below its desire not to be subject to the excess profits tax, it shall be exempt from such tax and the provisions of Supplement S, Chapter 1, shall apply to the shareholders in such corporation who were such shareholders on the last day of the taxable year of the corporation. (Attach Form 1121PS)

(c) If corporation claims exemption under section 727 of the Internal Revenue Code, state basis of claim

(d) If an excess profits tax return is not being filed for the reason that it is claimed that the excess profits net income computed under the invested capital method is not greater than $5,000, the following Schedule N should be filled in. The completion of Schedule N does not constitute the filing of an excess profits tax return.

Schedule N.—EXCESS PROFITS NET INCOME COMPUTATION

1. Normal-tax net income (computed without credit for income subject to excess profits tax) (item 40 plus item 38, page 1)	$
2. Net short-term capital gain (do not enter net short-term capital loss)	
3. 50 percent of interest on borrowed capital	
4. Adjustment to net operating loss deduction under section 711 (a) (2) (L)	
5. Total of lines 1 to 4	$

6. Dividends received credit adjustment (item 13, page 1, excluding the sum of (a) dividends received (actual or constructive) from foreign personal holding companies, and (b) dividends received on stock held primarily for sale to customers by a dealer in securities; minus item 39, page 1)	$
7. Net gain from sale or exchange of capital assets (item 12 (c), page 1)	
8. Income from retirement or discharge of bonds, etc.	
9. Refunds and interest on Agricultural Adjustment Act taxes	
10. Recoveries of bad debts	
11. Total of lines 6 to 10	$

Computation proved

Form 1121 — Department — Internal Revenue Service

Page 1

UNITED STATES CORPORATION EXCESS PROFITS TAX RETURN For Calendar Year 1943

1943

or fiscal year beginning ...., 1943, and ending ...., 1944

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

Merchants National Realty Corp. (Name)

300 Montgomery St. (Street and number)

San Francisco, California (City or Town) (State)

Business group serial number entered on page 1, Form 1120 182

File Code 498
Serial 800583
District 1st Cal

RECEIVED MAR 14 1944 COLLECTOR OF INT. REV. FIRST DIST. CALIF.

Cash Check M. O.

First payment

$

EXCESS PROFITS TAX COMPUTATION

	Column 1 Income Credit Method		Column 2 Invested Capital Credit Method	
...fits net income (line 16, Schedule A)	$		$ None	
...emption	$ 5,000		$ 5,000	
...fits credit—based on income (line 46, Schedule B)			x x x x x x x	x x
...fits credit—based on invested capital (line 41, Schedule C)	x x x x x x x	x x	1,290,195	29
...cess profits credit adjustment (attach schedule)				
... of items 2 to 5	$		$ 1,295,195	29
... between item 1 and item 6	$		$ None	
...excess profits net income (item 7, column 1, or item 7, column 2, whichever is applicable)			$	
... of item 8			$	
...e (computed without regard to the credit provided by section 26 (e)) (item 35, page 1, Form 1120)			$	
(a) Dividends received credit (85 percent of total of column 2, Schedule E, Form 1120 (excluding dividends received on certain preferred stock of a public utility), but not in excess of 85 percent of item 10 above)	$			
(b) Dividends paid on certain preferred stocks if taxpayer is a public utility (line 20, page 2, Form 1120)				
...t income (computed without regard to the credit provided by section 26 (e))			$	
... of item 12				
...x under Chapter 1 (other than section 102) for the taxable year (item 41, page 1, Form 1120)				
...item 13 over item 14			$	
... item 15, whichever is lesser			$	
...eferred by reason of the application of section 710 (a) (5) (relating to abnormality under section 722) (attach ...e)			$	
...fits tax: ...n 16 minus item 17	$			
...chedule is filed under question (g), page 2, amount of tax as computed in such schedule				
...n 18 (a) or item 18 (b), whichever is applicable			$	
Credit for income taxes paid to a foreign country or United States possession allowed to a domestic corporation (portion not used in computing item 42, page 1, Form 1120)				
...) minus item 19			$	
Credit for debt retirement (item 28, below)				
...inus item 21			$	
...f any, due to application of section 734 (adjustment in case of position inconsistent with prior income tax liability) ...schedule)				
...fits tax due (item 22 plus item 23, or item 22 minus item 23, whichever is applicable)			$ None	

POST-WAR REFUND OF EXCESS PROFITS TAX AND CREDIT FOR DEBT RETIREMENT

...f excess profits tax (item 18 (c), above)			$	
...owable under sections 780 and 781 (10 percent of item 25) (but in cases where item 19 is applicable, see Specific Instructions 25-29)			$	
...amounts paid on indebtedness or net reduction in indebtedness under section 783 (b) (2)	$			
...debt retirement allowable under section 783 (40 percent of item 27, but not in excess of 10 percent of item 25)				
...war refund credit (item 26 minus item 28)			$	

...rsigned, president (or vice president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the corporation for which this return is ...rally duly sworn, each for himself deposes and says that this return (including any accompanying schedules and statements) has been examined by him and is, to the best of ...d belief, a true, correct, and complete return, made in good faith, for the taxable year stated, pursuant to the Internal Revenue Code and the regulations issued thereunder.

...d and sworn to before me this 9th day of March, 1944

Joseph F. Burns (Signature of officer administering oath)
Notary Public in and for the City and County of San Francisco, State of California
My Commission Expires April 12, 1946

CORPORATE SEAL

(President or other principal officer) (State title) Pres

(Treasurer, Assistant Treasurer, or Chief Accounting Officer) (State title) Tre

...(or affirm) that I/we prepared this return for the person named herein and that the return (including any accompanying schedules and statements) is a true, correct, ...tement of all the information respecting the excess profits tax liability of the person for whom this return has been prepared of which I/we have any knowledge.

...d and sworn to before me this 9th day of March, 1944

C. O'Neill (Signature of person preparing the return)

(Signature of person preparing the return)

Joseph F. Burns (Signature of officer administering oath)
Notary Public in and for the City and County of San Francisco, State of California
My Commission Expires April 12, 1946

16—28810-2 (Name of firm or employer, if any)

QUESTIONS

corporation **May 13, 1927** (b) State or country **Delaware**

office in which your income tax return for the taxable year was filed **1st California**

nsolidated return? **No** If so, procure from the collector Form 851, Affiliations Schedule, which shall be filled in, sworn to, and filed t of the consolidated income tax return.

ng the excess profits credit under the invested capital method, do you elect to include in excess profits net income interest received on, reduced mount of amortizable bond premium under section 125 attributable to, all Government obligations described in section 22(b)(4) of the Internal Code? (Answer "yes" or "no") **No**

transferor or transferee upon an exchange as defined by section 760 or 761 of the Internal Revenue Code? (Answer "yes" or "no") **No**

eturn involve an adjustment of the excess profits tax liability due to the application of the sections specified in (1) below? (Answer "yes" **No** If answer is "yes":

eck the appropriate sections and submit schedules showing computation: 710(a)(4) ☐; 721 ☐; 726 ☐; 731 ☐; 735(b) ☐; 735(c) ☐; 736(a) ☐; 736(b) ☐. (See General Instructions E, F, G, H, and I.) (Enter amount of excess profits tax as Item 18 (b), page 1.)

om the schedules submitted under (1) above, enter any tax adjustment which results from the application of each of the following sections: 721, $.......; 726, $.......; 731, $.......

om the schedules submitted under (1) above, enter any income adjustment which results from the application of each of the following sections: 721, $.......; 731, $.......; 735(b), $.......; 735(c), $.......

unt of total assets as of the end of the taxable year. (From Form 1120, page 4, line 8, last column), $.......

Schedule A.—EXCESS PROFITS NET INCOME COMPUTATION

	Column 1 Income Credit Method		Column 2 Invested Capital Credit Method	
x net income (computed without allowance of credit for income subject to excess profits without allowance of dividends received credit) (item 37, page 1, Form 1120)	$		$ None	
term capital gain (do not enter net short-term capital loss)				
t to net operating loss deduction				
n deductions limited by income				
of interest on borrowed capital	x x x x x x x x	x x		
Government obligations (see question (c) above, for election)	x x x x x x x x	x x		
al of lines 1 to 6	$		$	
rom sale or exchange of capital assets (item 12 (a), page 1, Form 1120)	$		$	
om retirement or discharge of bonds, etc.				
nd interest on Agricultural Adjustment Act taxes				
of bad debts				
deductions limited by income				
nds received credit adjustment (item 13, page 1, Form 1120, excluding dividends received n foreign corporations)			x x x x x x x	x x
nds received credit adjustment (item 13, page 1, Form 1120, excluding dividends received from foreign personal holding companies and dividends received on stock held primarily for sale to customers by a dealer in securities)	x x x x x x x	x x		
le income of certain industries with depletable resources				
tal of lines 8 to 14	$		$	
ofits tax net income computed without regard to deductions applicable to life insurance ies (line 7 minus line 15)	$		$	
s applicable to life insurance companies				
ofits net income computed under income credit method or invested capital credit method , or line 16 minus line 17 in case of a life insurance company)	$		$ None	

16—33310-2

Note: - This company is a subsidiary of Bank of America NT & SA and operated at neither gain or loss per rent agreement with parent corporation.

Merchants National Realty Corp.
1943 Schedules

Gain & Loss—Sale of non-Capital Assets—Line 12 B

Item	Amount Received	Cost	Impr. Exp.	Depr. Allowed	P/L
Bank Premises	$ 84,650.00	$ 87,919.10	$ 4,143.65	$ 20,226.96	$12,814.21
Other Real Estate	$1,302,594.65	1,297,176.10	37,983.41	99,924.03	67,359.17
Total	$1,387,244.65	$1,385,095.20	$42,127.06	$120,150.99	$80,173.38

Other Income—Line 14

Discounts	$ 62.21	
General Privileges	129.35	$191.56

Taxes—Line 22

Real Estate	$343,045.14	
Franchise—Delaware	150.00	
Franchise—California	25.00	$343,220.14

Losses—Line 24

Fires—not insured	$2,625.63

Depreciation—Line 25

	Cost	Depreciation Prior Years	Balance	Depreciation 1943
Buildings	$15,164,324.82	$4,076,999.35	$11,087,325.47	$392,572.40

Other Deductions—Line 29

Office Expense	$ 29.18	
Telephone	1,384.67	
Management Fee	60,000.00	
Maintenance & Repairs	71,599.46	
Utilities	16,646.74	
Laundry—Towels, etc.	2,476.19	
Building Supplies	969.92	
Insurance	25,171.24	
Tenant Charges	6,550.43	
Operating Expenses	12,424.65	
Pension Expense	463.37	$197,715.85

Statement of Affiliations—Q 9

Parent	% Owned	Date Acquired	Return Filed
Bank of America N.T. & S.A.—S. F.	100	10/1/31	San Francisco

Statement of Salary Adjustments—Q 11

Made in accordance with salary rate schedules established before 10/3/42. Otherwise authorizations on file.

Admitted November 7, 1949.

Mr. Koster: That concludes the presentation. The Petitioner rests.

The Court: Now, those first exhibits, Q, R, and S, are little booklets. Do they more or less speak for themselves?

Mr. Koster: Yes. They are annual reports of the Bank of America and Transamerica Corporation.

Mr. Crouter: I have only a correction to make, if the Court please. A few moments ago, when I referred to the question of consideration of tax matters, I believe I inadvertently referred to Exhibit 20-T and that should have been Exhibit 14-N. That would be straightened out on brief but I wouldn't want that to stand as an error in the record. Respondent has nothing further to submit.

The Court: The briefs in this case will be due December 28th, the original briefs, and January 26, 1950, for the reply briefs.

This proceeding is now submitted.

Mr. Koster: Thank you.

Mr. Crouter: Thank you.

(Whereupon, at 6:05 o'clock p.m., the hearing in the above-entitled matter was concluded.) [26]

Certificate

I, Franklin R. Greene, one of the official reporters of the Tax Court of the United States under its reporting contract, assigned to report certain proceedings during the session of The Tax Court in

San Francisco, California, beginning November 7, 1949, do hereby Certify as follows:

That I reported all of the proceedings in the case of Bank of America National Trust and Savings Association, Docket No. 8993, on November 7, 1949, before the Honorable Marion J. Harron, Judge of The Tax Court;

That I did well and truly, to the best of my ability, record in Stenotypy fully, completely and accurately all of the proceedings which I was assigned to report, including all colloquy and statements made during the proceedings, and all questions to and answers given by witnesses;

That my stenotype record is full, complete and accurate; and

That the foregoing record is a true, complete and accurate transcript of my stenotype notes of all the proceedings which I reported, and all of the testimony which was taken in the above-entitled cause.

/s/ FRANKLIN R. GREENE,
Reporter.

Date: Nov. 23, 1949.

Filed T.C.U.S., December 7, 1949.

The Tax Court of the United States

Docket No. 8993

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Promulgated October 20, 1950

FINDINGS OF FACT AND OPINION

Petitioner transferred legal title to eight of its banking premises to Capital Company for a consideration which was less than the adjusted bases of the properties. Capital Company was the wholly owned subsidiary of a holding company which owned a substantial interest in petitioner. Prior to the transfers, the parties agreed orally that title to the properties would be reconveyed on petitioner's command to petitioner, or to its wholly owned subsidiary, Merchants, in about 30 days for the same consideration as was originally advanced. During the time Capital Company held title to the properties, it was paid a "rental" calculated to yield a return to it of 6 per cent per year upon the amounts advanced to petitioner. After approximately 30 days, Capital transferred formal title to the bank premises to Merchants.

Merchants was a wholly owned subsidiary of petitioner which had no salaried employees of its

own. Its only business was the ownership of property which it leased to petitioner, and whatever work was necessary to the operation of this business was performed by employees of petitioner. Petitioner had complete dominion and control over Merchants and the properties transferred to it.

Held:

1. The sale to Capital Company was not bona fide, and Capital Company was a mere conduit for the conveyance of legal title from petitioner to Merchants.

2. The transactions between petitioner and Merchants lacked substance and reality, and petitioner did not suffer a deductible loss therefrom. Higgins v. Smith, 308 U. S. 473, followed.

George H. Koster, Esq., for the petitioner.
Earl C. Crouter, Esq., for the respondent.

The Commissioner originally determined a deficiency in petitioner's income tax liability for 1943 in the amount of $915,040.93 and a deficiency in petitioner's declared value excess profits tax liability for 1943 in the amount of $161,650.70. In an amended answer, the Commissioner has made claim for increased deficiencies in both taxes, increasing the deficiencies to $942,337.38 and $166,472.87, respectively, upon his determination that petitioner had additional income in 1943. The petitioner concedes that the increase in the amount of its taxable income, in this respect, is correct.

The issue in this proceeding is whether the transfer by petitioner of the legal title to eight of its

banking premises for a price which was less than the adjusted bases of the properties resulted in deductible losses to petitioner in the amount of $464,811.68 where, pursuant to an oral agreement with petitioner, the transferee corporation reconveyed title to the banking premises to a wholly owned subsidiary of petitioner about 30 days later.

Other adjustments made by respondent in petitioner's income are not in dispute.

Petitioner filed its returns for the year in question with the collector for the first district of California.

The record in this proceeding consists of a stipulation of facts and various joint exhibits.

Findings of Fact

All of the facts which have been stipulated are found as stipulated.

Petitioner is a national banking association which was incorporated on March 1, 1927, under the laws of the United States. It operates a banking system in California through approximately 500 branches, and has its principal place of business in San Francisco. Title to some of the buildings in which petitioner conducts its banking business is held in the name of petitioner, and title to other properties is held in the name of petitioner's wholly owned subsidiary, Merchants National Realty Corporation (hereinafter referred to as "Merchants").

At all times pertinent to this proceeding, Merchants was a wholly owned subsidiary of petitioner. Many of the officers and directors of petitioner

were also officers and directors of Merchants. The only business of Merchants was the ownership of property which it leased to petitioner. Merchants had no salaried employees. Whatever work was necessary to the operation of its business was performed by employees of petitioner. Merchants' place of business was in the headquarters of petitioner in San Francisco.

The basic lease ageements under which petitioner leased property from Merchants provided that in exchange for a 10-year lease, petitioner would pay to Merchants as rent "an amount equal to the total of all expenses and charges of the Lessor, which are allowable to the Lessor, Merchants National Realty Corporation, as deductions from gross income for Federal income tax purposes, less an amount equal to the total income of the Lessor derived from all services other than the rental to be paid hereunder."

On August 31, 1939, bank examiners from the office of the United States Comptroller of the Currency determined that the values of the banking properties in the books of petitioner were in excess of their fair market value, and they recommended that petitioner be required to reduce the book values to the actual values of the banking properties in its books. Petitioner refused to comply with the recommendation of the bank examiners and contended that the Comptroller of the Currency did not have the authority to require it to write down the value of any of its assets. After a number of conferences and exchanges of correspondence be-

tween petitioner and the Office of the Comptroller of the Currency, an agreement was reached on March 6, 1940, as to the amount at which each banking property should be carried on petitioner's books. This agreement provided that "the unallocated reserve set up by the Bank shall be reduced by the difference between the present carrying value of each such premise and the value of such as determined by the committee [comprised of three Government banking officers]. * * * The remainder of such reserve, if any, may be returned to the undivided profits accounts." In March, 1941, petitioner informed the committee that:

> We will agree to establish a new cost basis for the bank premises listed in Exhibit "A" hereto attached in such manner as will result in a charge of approximately $1,000,000 against our profits for the period ending June 30, 1941, and a similar charge in the third quarter of 1941. The new cost basis to be established shall be determined from the American Appraisal Company appraisal, using the lowest appraisal of the American Appraisal Company as to the particular properties involved. No adjustment will be made as to properties with respect to which American Appraisal Company's most adverse appraisal exceeds book value.

The committee recommended that $2,000,000 be written off by petitioner in 1941 and $2,000,000 be written off in 1942. The Comptroller of the Currency accepted this proposal and informed peti-

tioner to that effect. The Comptroller also informed petitioner that:

> Any or all of the amount may be charged to Undivided Profits instead of the Unallocated Reserve if desired, the amount of that Reserve, however, not to be reduced below $4,000,000 except after writeoff of the $2,000,000 in 1941 and approximately $2,000,000 in 1942.

The petitioner informed the Comptroller that these arrangements for a "reduction in book value of banking premises" were satisfactory to it.

George H. Koster, one of petitioner's counsel, was asked by petitioner if he could advise it of a method whereby the Comptroller's requirement that the properties be written down could be met, without at the same time receding from petitioner's position that it was entitled to carry the properties at cost. He gave suggestions to the petitioner in a memorandum to petitioner dated January 10, 1941, part of which is set forth in the margin.[1]

Koster and L. M. Giannini, president of petitioner, discussed the tax effects of the transactions and the results to be achieved by them with a

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[1] * * * The Bank called me into the matter, explaining to me the controversy and asked me to advise them of a method by which they could comply with this accord without receding from their position that they should be entitled to carry their properties at cost.

I advised them that they could probably arrange to purchase and sell properties between the Bank and Merchants National Realty Corporation, so that the purchase price of the respective properties would be a figure satisfactory to the Committee and in accordance with the agreement. The Bank

representative of the Comptroller who informed them that the Comptroller could not pass upon the tax consequences of any of the transactions.

Transamerica Corporation is a holding company. It owns substantial amounts of stock of many banks and industrial concerns. During 1941, 1942, and 1943, either Transamerica Corporation or its subsidiary companies owned common and preferred stock of petitioner, each of which had equal voting rights. During 1941, 1942, and 1943, the outstanding common stock of petitioner amounted to 4,000,000 shares; and there was preferred stock outstanding in the amount of 540,000 shares in 1941, 460,796 shares in 1942, and 405,146 shares in 1943. Transamerica and its subsidiaries owned

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officers felt that since it was a transaction between the parent and a wholly owned affiliate, the purchase and sale transaction might be ignored and the transaction considered a write-down which would establish a precedent whereby the Bank might be compelled to continue the practice of arbitrarily writing down its banking premises. The Bank, of course, did not wish to establish a precedent or to be in a position where it could ever be faced with the contention that it had previously recognized the legality of any requirement by the Comptroller of Currency that banking premises should be arbitrarily written down.

I then suggested that if the Bank and Merchants National Realty Corporation should be willing to assume the risks which might result where property is removed from their hands even for a short period of time, they might arrange with some other company, such as Capital Company, to purchase the property from one and then sell to the other. Capital Company may do this as an accommodation since they have had considerable dealings with the

common and preferred stock of petitioner in 1941, 1942, and 1943 in the total amounts set forth below:

Stock Owned by Transamerica and Subsidiaries

	1941	1942	1943
Common	899,820	692,394	570,134
(outstanding)	(4,000,000)	(4,000,000)	(4,000,000)
Preferred	500,844	425,174	370,634
(outstanding)	(540,000)	(460,796)	(405,146)

Capital Company (hereinafter referred to as "Capital") is a wholly owned subsidiary of Transamerica Corporation and is engaged in the real estate business.

Sometime in 1941, R. G. Smith, who was the executive vice-president of petitioner and the president of Merchants, conferred with E. C. Woodruff, the president of Capital. An agreement was reached between these two executives in behalf of their respective companies. The parties to this

Bank, but it would seem they might and would probably be justified in being compensated for the work involved in the transfers of the property. Such an arrangement would avoid the element of direct transactions between affiliated companies, at least in form, even though the effect might be the same. Of course, the element of risk in transactions such as this, would be a distinction as against direct transactions between the affiliated companies.

The officers of the Bank inquired as to the results of such transactions for tax purposes and especially whether there was anything wrong in transactions such as this. I told them there is nothing in the tax law which prohibits business transactions having a definite purpose, just so long as those transactions are not used for the purpose of defrauding the Government of taxes. * * *

proceeding have stipulated that this agreement provided:

> * * * That the Bank [petitioner] or Merchants would execute deeds to Capital Company with respect to [certain] banking premises * * * ; that Capital Company would accept delivery of such deeds; that Capital Company would deliver its checks to the Bank [petitioner] and to Merchants in amounts equal to the value of said premises as appraised by the American Appraisal Company; that the Bank [petitioner] intended to and would receive back, deeds to the said property within thirty days or so after delivery of deeds thereto to Capital Company, and Capital Company agreed to execute and deliver deeds to said property to the Bank or Merchants at any time upon request of the Bank; that there would not be any written agreement between the Bank, Merchants and Capital Company providing for the execution and delivery of deeds from Capital Company to the Bank or to Merchants; that when the Bank requested delivery of deeds to such property from Capital Company to it or to Merchants, the Bank or Merchants would give its check to Capital Company for the same amount of the check which Capital Company gave the Bank or Merchants for the respective property, plus acquisition costs incurred by Capital Company in connection with the transaction; and that between the time of the delivery of the deeds with respect to the respec-

> tive properties from the Bank or from Merchants to Capital Company, and the time of the delivery of the deeds with respect to the respective properties from Capital Company to the Bank or to Merchants, the Bank would pay to Capital Company as rental amounts equal to 6% per annum net upon the amounts paid by Capital Company to the Bank or to Merchants, as aforesaid. * * *

Pursuant to this agreement, Merchants deeded four of the banking premises to which it held title to Capital in 1941, and Capital, in turn, deeded the properties to petitioner shortly thereafter. The amounts paid by petitioner to Capital were the same as the amounts which had been paid by Capital to Merchants. Merchants showed losses from these transactions on its books and in its tax return in the total amount of $503,373.97. In 1942 Merchants similarly deeded ten of the banking premises to which it held title to Capital which, in turn, deeded them to petitioner for the same amounts which it had paid to Merchants. Merchants showed losses from these transactions in the amount of $463,593.85 on its books and in its tax return.

In the year 1941, petitioner executed and delivered to Capital deeds to 16 banking premises. About 30 days after each deed was delivered to Capital, Capital executed and delivered a deed to the same property to Merchants. The amounts received by petitioner from Capital were the same as the amounts which were paid to Capital by Merchants. According to petitioner's books and tax

return, these transactions resulted in losses to it in 1941 which totalled $1,383,039.64. In the year 1943, petitioner executed and delivered to Capital deeds to eight banking premises. About 30 days after each deed was delivered, Capital executed and delivered a deed to the same property to Merchants. The amounts received by petitioner from Capital for these properties were the same as the amounts received by Capital from Merchants. The details of the 1943 transactions are set forth in the following schedule:

Properties Deeded by Petitioner in 1943 to Capital, and Deeded by Capital to Merchants.

Property	Cost	Reserve for Depreciation	Net Cost	Rec'd by Pet. From Capital	Revenue Stamps	Loss per Pet.'s Books and Return	Deed to Capital	Deed to Merchants
Palo Alto	$ 200,575.94	$ 41,441.37	$ 159,134.57	$ 107,788.76	$ 118.80	$ 51,464.61	5- 7-43	6- 8-43
Fall Brook	10,561.60	1,329.30	9,232.30	7,477.09	8.25	1,763.46	5- 7-43	6- 8-43
Sacramento	1,505,312.78	445,475.13	1,059,837.65	971,262.59	1,068.65	89,643.71	6-30-43	7-29-43
Santa Maria	72,230.47	13,885.67	58,344.80	52,019.79	57.75	6,382.76	5- 7-43	6- 8-43
Oakland	2,076,834.44	378,437.66	1,698,396.78	1,441,888.17	1,586.20	258,094.81	6-30-43	7-29-43
Balboa	43,075.90	9,418.55	33,657.35	30,554.28	34.10	3,137.17	5- 7-43	6- 8-43
Mission	278,556.23	21,434.71	257,121.52	208,821.54	229.90	48,529.88	3-31-43	4-30-43
McArthur	45,047.70	5,642.65	39,405.05	33,647.17	37.40	5,795.28	5- 7-43	6- 8-43
Total	$4,232,195.06	$917,065.04	$3,315,130.02	$2,853,459.39	$3,141.05	$464,811.68		

The only losses directly involved in this proceeding are those claimed by petitioner for the year 1943 in the amount of $464,811.68.

In carrying out the aforesaid transactions, all formalities in connection therewith, such as the execution and recording of deeds, the affixing of documentary stamp taxes, the transfer of fire insurance, and the recording of the transactions on the books of all companies as purchases and sales of property, were complied with. When the properties were deeded to Capital, the outstanding fire insurance policies covering the respective properties were amended by riders to provide that any loss payable thereunder should be paid to Capital; and when Capital deeded the properties to petitioner or to Merchants, the policies were again amended by riders to provide that any loss payable thereunder should be paid to petitioner or to Merchants, respectively.

Upon the execution and delivery of the deeds to the respective properties by petitioner or Merchants to Capital, petitioner and Capital executed a "lease" agreement with respect to each property, which provided for the payment by petitioner to Capital of a "rental" equal to a return of 6 per cent per year to Capital on the money which it had paid out.

All of the properties to which Merchants acquired formal title through Capital were immediately leased by Merchants to petitioner under the same form of a basic lease agreement between those parties as stated above.

At all times pertinent to this proceeding, the

banking properties which were the subject of the transactions involved herein were occupied and used by ranches of petitioner. It was not contemplated at any time that there would be any interruption or change in the use and occupancy of the banking properties by the branches of petitioner which occupied them.

The explanation given by the respondent in the notice of deficiency for disallowing the claimed loss deduction is set forth in the margin.[2]

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[2](1) Net loss claimed on the sale of assets other than capital assets includes losses of $464,811.68 on the sale of certain banking premises to the Capital Company. The Capital Company held legal title to these properties for a period of one month and received rent from you for such period of ownership. The properties were then sold by the Capital Company to the Merchants National Realty Corporation, your wholly owned subsidiary.

The Transamerica Corporation controlled all of the outstanding shares of the Capital Company. Approximately 22 per cent of your stock was owned by the Transamerica Corporation group.

Under date of August 1, 1936, you entered into an agreement with the Merchants National Realty Corporation whereby you leased from the Merchants National Realty Corporation certain banking premises. The rental was to be an amount equal to the total of all expenses and charges of the lessor allowable to said lessor as deductions from gross income for federal income tax purposes, less an amount equal to the total income of the lessor derived from all other sources. The result of this agreement is that all operations of the Merchants National Realty Corporation were merged with your operations, leaving no income of the Merchants National Realty Corporation subject to income tax.

Capital was merely a conduit through which petitioner made formal transfers of the title to the eight properties involved in this proceeding to its subsidiary, Merchants. The transfers of title to the eight properties by petitioner to Capital did not constitute bona fide sales of the parcels of property to Capital.

Petitioner at all times had complete ownership, dominion, and control over Merchants and over each of the eight parcels of property.

Opinion

Harron, Judge: The issue in this proceeding is whether transfers by petitioner of the legal title to eight of its banking properties resulted in deductible losses under section 23(f).

Petitioner contends (1) that the transfers of properties to Capital were bona fide sales which resulted in deductible losses; and (2) that even if the transactions are viewed as sales of the properties by petitioner to Merchants, the fact that Merchants was a wholly owned subsidiary of petitioner does not require disallowance of the claimed deductions.

Respondent contends that the losses are not deductible because petitioner never relinquished dominion and control over the properties. With respect to the transfers to Capital, respondent con-

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It is held that no deductible loss resulted from the sale of banking premises to the Capital Company. Your taxable income is, therefore, increased $464,811.68.

tends that the transfers did not constitute bona fide sales because of Capital's oral agreement to retransfer the properties to Merchants, a wholly owned subsidiary of petitioner. With respect to the transfers to Merchants, respondent contends that no loss was sustained by petitioner as a result of the transfers of the title to the properties to Merchants. Respondent emphasizes the point that Merchants was a wholly owned subsidiary of petitioner, subject to petitioner's complete dominion and control, and that the "lease" arrangements with Merchants were not arms-length lease agreements such as would be made with a stranger.

In order for a loss upon the sale of property to be deductible, it must be established by a bona fide sale. Higgins v. Smith, 308 U. S. 473. See, also, Regulations 111, section 29.23(e)(1), (f)(1). And the loss must be actual and real. Gregory v. Helvering, 293 U. S. 465; Burnet v. Huff, 288 U. S. 156; Weiss v. Wiener, 279 U. S. 333. Also, under section 23(f), a taxpayer must prove that a loss is sustained. The transactions between petitioner and Capital do not satisfy these requirements.

All of the facts in this proceeding have been stipulated, and they are not in dispute. In fact, the petitioner has not concealed at any time any of its arrangements, but has made full disclosures of them, at least as far as this proceeding is concerned. The facts show that petitioner conveyed the legal title to the properties to Capital, and that it meticulously complied with all of the customary formalities necessary for the transfers of title.

However, transfer of naked legal title is but one of the elements to be considered in determining the true nature of a transaction. United States v. Utah-Idaho Sugar Co., 96 Fed. (2d) 756. The other circumstances present in this proceeding establish that there was not a bona fide sale of the properties to Capital with a complete termination of petitioner's interests in the properties.

Prior to the transfer of the banking properties to Capital, petitioner reached an agreement with Capital which provided:

> * * * that the Bank [petitioner] intended to and would receive back, deeds to the said property within thirty days or so after delivery of deeds thereto to Capital Company, and Capital Company agreed to execute and deliver deeds to said property to the Bank or Merchants at any time upon request of the Bank; that there would not be any written agreement between the Bank, Merchants and Capital Company providing for the execution and delivery of deeds from Capital Company to the Bank or to Merchants; that when the Bank requested delivery of deeds to such property from Capital Company to it or to Merchants, the Bank or Merchants would give its check to Capital Company for the same amount of the check which Capital Company gave the Bank or Merchants for the respective property, plus acquisition costs incurred by Capital Company in connection with the transaction; * * *

Where a sale is made as part of a composite plan which includes, as in this proceeding, an agreement for the reacquisition of the property sold, and the plan is carried out, any loss suffered as a result of the "sale" of the property is not deductible. Pierre S. DuPont, 37 B.T.A. 1198; aff'd., 118 Fed. (2d) 544; certiorari denied, 314 U. S. 623; Sidney M. Shoenberg, 30 B.T.A. 659; aff'd., 77 Fed. (2d) 446; Foster v. Commissioner, 96 Fed. (2d) 130; Commissioner v. Dyer, 74 Fed. (2d) 685; certiorari denied, 296 U. S. 586. It makes no difference that the property is to be reacquired by a subsidiary or a close affiliate of the original seller, rather than by the seller itself. Rand Company, 29 B.T.A. 467; aff'd., 77 Fed. (2d) 450; John M. Burdine Realty Co., 20 B.T.A. 54. The reason for the general rule was stated by the Court of Appeals in Shoenberg v. Commissioner, 77 Fed. (2d) 446, 449, as follows:

> A loss as to particular property is usually realized by a sale thereof for less than it cost. However, where such sale is made as part of a plan whereby substantially identical property is to be reacquired and that plan is carried out, the realization of loss is not genuine and substantial; it is not real. This is true because the taxpayer has not actually changed his position and is no poorer than before the sale. The particular sale may be real, but the entire transaction prevents the loss from being actually suffered. Taxation is concerned with realities, and no loss is deductible which is not real.

The facts in this proceeding show beyond any doubt that there were no real and complete sales of any of the banking properties to Capital by petitioner in 1943 which can be recognized for tax purposes. Petitioner never relinquished dominion or control over the eight properties to Capital. Petitioner intended only a temporary vesting of title in Capital, and it was assured of its ability to recover the properties under its oral agreement with Capital.

Petitioner argues that it lost dominion and control over the properties because it could not have compelled Capital to reconvey the properties to it or its subsidiary. In other words, petitioner now asserts that its oral agreement violated the requirement of the statute of frauds that all agreements for the transfer of title to real property must be in writing, and, therefore, the oral agreement with Capital is now said to have been an invalid agreement. Aside from the point that partial performance probably took the transaction out of the reach of the statute of frauds, the fact is that the oral agreement actually was executed by the reconveyance of title to the properties by Capital and it was the intention of the parties that Capital should be merely a conduit through which petitioner could transfer formal title to Merchants.

The petitioner also refers us to Bancitaly Corporation, 34 B.T.A. 494, 509-16, in support of its contention that the transaction with Capital was a completed transaction which should be recognized for tax purposes, and contends that a hold-

ing in this proceeding which would sustain the respondent's determination, that is, a holding to the effect that the steps followed in the transaction with Capital had no substantive effect, would be inconsistent with our holding in Bancitaly Corporation. However, we find little similarity between this proceeding and that of Bancitaly Corporation in the matter of either the facts or the issue involved in the respective proceedings. In the Bancitaly case, the Bancitaly Corporation sold 150,000 shares of stock and subsequently reacquired 84,198 of the shares which it had sold. The issue in the case was whether the Bancitaly Corporation realized taxable income upon the sale of the 84,198 shares which it subsequently repurchased. As the basis for the holding that taxable income was realized, the Board expressly found as a fact that the sale of 150,000 shares of stock and the subsequent repurchase of 84,198 of the shares were two separate and independent transactions and that the original purchaser was under no obligation to resell any of the shares to petitioner. In this proceeding, however, Capital was merely a conduit for the passage of title to the eight bank properties from petitioner to Merchants. Capital was obligated to deliver deeds to the eight branch banks back to petitioner or Merchants, and the parties never intended, under any circumstances, that Capital should retain title to any of the eight properties.

In the last analysis we must weigh the evidence in this proceeding and make an independent determination about the transaction which is involved

here. This we have done, and we have concluded that respondent's determination on this issue must be sustained. The interjection of Capital between petitioner and Merchants does not insulate the transactions from any infirmities arising from the fact that Merchants was a wholly owned subsidiary of petitioner, subject to petitioner's complete dominion and control. The sale must be viewed as being made between petitioner as vendor and Merchants as vendee, and the question thus becomes what effect does the closeness of the relationship between petitioner and Merchants have upon the deductibility of the loss in question.

This is not a new question. In Higgins v. Smith, supra, the Supreme Court considered the question of whether a sale of stock at a loss by an individual to a corporation which was wholly owned by him resulted in a deductible loss to the individual. The business of the corporation consisted of buying and selling securities, largely from and to the taxpayer. The Supreme Court held that "domination and control is so obvious in a wholly owned corporation as to require a peremptory instruction that no loss in the statutory sense could occur upon a sale by a taxpayer to such an entity." See, also, Crown Cork International Corporation, 4 T.C. 19; aff'd., per curiam, 149 Fed. (2d) 968.

Petitioner attempts to distinguish Higgins v. Smith and Crown Cork International Corporation, supra, on the ground that in those cases no business purpose other than the saving of taxes was shown, while in this proceeding it claims that it has shown

another business purpose, namely, to satisfy the demands of the Comptroller of the Currency. However, the basis of the Smith and Crown Cork International Corporation cases was not that the transactions in question were designed to save taxes, but that they lacked substance and reality because of the continued control of the taxpayer over the property transferred through its domination and control of the wholly owned corporation which received the property. Indeed, both cases cite Gregory v. Helvering, supra, which is authority for the rule that an intent to save taxes is not to be condemned, and a taxpayer may resort to any legal means to accomplish that result. Moreover, petitioner has not shown that the Comptroller of the Currency required that the bank properties be sold. The only requirement of the Comptroller was that petitioner write down the value at which it carried the properties on its books by charging the excess of book value over fair market value to a surplus account. This was consistent with the general authority of the Comptroller contained in the National Bank Act, United States Code, Title 12, passim, and the decision of the Supreme Court in Thomas v. Taylor, 224 U. S. 73; cf. Yates v. Jones National Bank, 206 U. S. 158. The evidence shows that possible tax advantages were an important consideration in arriving at the complicated form in which the simple requirement of the Comptroller was met.

However, the ground for this decision is not whether or not the intent to effect a tax savings was the dominant purpose of petitioner. The basis for

the decision is the complete dominion and control which petitioner continued to exercise over the properties transferred through its complete domination and control of its wholly owned subsidiary. Petitioner makes no argument that such dominion and control did not exist. In light of the stipulated facts, it can not. Petitioner owned all the outstanding stock of Merchants, and the two corporations had interlocking officers and directors. Merchants had no independent business or economic life of its own. It had no salaried employees, and whatever work was necessary to the operation of its business was performed by employees of petitioner. The only business in which Merchants was engaged was the ownership of the property which it leased to petitioner. However, the lease agreements between petitioner and Merchants were not arms-length transactions such as would be entered into with a stranger. The rental formula between the parent and the subsidiary provided that Merchants would receive as rent from petitioner an amount equal to the total of all expenses and charges, including depreciation, allowable to Merchants as deductions from gross income for Federal income tax purposes, less any income derived by Merchants from any other incidental source. Thus, for Federal income tax purposes, Merchants could never show a profit or a loss.

In order for a taxable gain to be realized or a deductible loss to be sustained, property must in general be sold, abandoned, discarded, or otherwise disposed of. Just as the appreciation in value of

property without its disposition does not result in a taxable gain, similarly the mere shrinkage in value of property does not constitute a deductible loss. Gulf Power Co., 10 T.C. 852; C. F. Mueller Co., 40 B.T.A. 195; White Star Line, 20 B.T.A. 111. In effect, petitioner is claiming a loss upon the diminution in value of certain of its fixed assets. The fact that the write-down which reflected the shrinkage in value was accomplished through the medium of a "sale" to its wholly owned subsidiary, Merchants, does not, under the doctrine of Higgins v. Smith, supra, effect a change in its essential nature from that of an accounting entry designed to account for the diminution in value of assets still controlled by petitioner. It makes no difference that the write-down was pursuant to a recommendation of the Comptroller of the Currency. See Gulf Power Co., supra, with respect to accounting rules and orders of the Federal Power Commission; Old Colony R. Co. v. Commissioner, 284 U. S. 552, and Gulf, Mobile & Northern R. Co. v. Commissioner, 83 Fed. (2d) 788, with respect to accounting rules and orders of the Interstate Commerce Commission; and National Airlines, Inc., 9 T.C. 159, with respect to accounting rules and orders of the Civil Aeronautics Board.

The facts clearly show that there is no substance to the sale of the branch banks by petitioner to its wholly owned subsidiary. Petitioner had complete domination and control over Merchants, and the properties in the hands of Merchants were as much subject to petitioner's control as they were while

legal title was in petitioner's own name. Higgins v. Smith, supra; Sidney M. Shoenberg, supra; Thal v. Commissioner, 142 Fed. (2d) 874; cf. Corliss v. Bowers, 281 U. S. 376. In effect and substance Merchants was no more than the alter ego of petitioner, and "no loss could occur upon a sale by a taxpayer to such an entity."

The respondent's determination is sustained.

Decision will be entered under Rule 50.

Served October 20, 1950.

The Tax Court of the United States
Washington

Docket No. 8993

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determinations of the Court, as set forth in its Findings of Fact and Opinion promulgated on October 20, 1950, respondent has filed recomputation of petitioner's liability for taxes for the year 1943 under Rule 50, to which petitioner does not object. Accordingly, it is

Ordered and Decided: That for the year 1943

there are deficiencies in income tax and declared value excess profits tax in the amounts of $942,-337.38 and $166,472.87, respectively, of which deficiencies in taxes payments were made by the payment after the mailing of the notice of deficiency of $915,040.93 in income tax and $161,650.70 in declared value excess profits tax, so that there are now net deficiencies in income tax and declared value excess profits tax in the amounts of $27,296.45 and $4,822.17, respectively.

[Seal] /s/ MARION J. HARRON,
Judge.

Entered Dec. 22, 1950.

Served Dec. 26, 1950.

In the United States Court of Appeals
for the Ninth Circuit
Docket No. 8993

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REVIEW BY THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

To the Honorable, the Judges of the United States Court of Appeals for the Ninth Circuit:

Bank of America National Trust and Savings Association, a national banking association, by its attorneys hereby petitions this Honorable Court to review the decision of the Tax Court of the United States entered on December 22, 1950, finding a deficiency in income taxes and excess profits taxes aggregating $32,118.62 for the calendar year 1943, and failing to find that the petitioner had overpaid its taxes for the said year. The said deficiency of $32,118.62 determined by the Tax Court has been paid since the entry of the Tax Court's decision.

I.

Jurisdiction

Petitioner is a national banking association or-

ganized and existing under and by virtue of the laws of the United States of America and maintains its principal office in San Francisco, California.

The income tax return and the declared value excess profits tax return of petitioner for the year 1943 was filed with the Collector of Internal Revenue for the First District of California, San Francisco, California, all within the jurisdiction of the United States Court of Appeals for the Ninth Judicial Circuit.

The jurisdiction of this Court to review the decision of the Tax Court of the United States aforesaid, is founded on Sections 1141 and 1142 of the Internal Revenue Code.

II.

Prior Proceedings

On June 5, 1945, the Commissioner of Internal Revenue mailed a Notice of Deficiency in accordance with Section 272 of the Internal Revenue Code, proposing deficiencies in income and declared value excess profits taxes for the year ended December 31, 1943, as follows:

Income Tax	$ 915,040.93
Declared Value Excess Profits Tax..	161,650.70
Total	$1,076,691.63

Petitioner duly filed its petition for redetermination of said deficiency in the Tax Court of the United States within the time provided by law.

During the pendency of the proceeding before the Tax Court, the petitioner paid the aforesaid proposed deficiencies and sought refund thereof through the said Tax Court proceeding. A hearing before the Tax Court was held in the City of San Francisco, California, on November 7, 1949. The Tax Court promulgated its findings of fact and opinion on October 20, 1950, and in sustaining the Commissioner, the Tax Court determined deficiencies in excess of those proposed by the Commissioner of $27,296.45 in income tax and $4,822.17 in declared value excess profits tax, and the decision of the Tax Court to that effect was entered on December 22, 1950. Since the entry of that decision, these additional deficiencies have been paid by the petitioner and the petitioner is seeking a refund of tax overpayment in this proceeding.

III.

Nature of the Controversy

The controversy herein involves the petitioner's correct income and declared value excess profits tax liability for the calendar year 1943, which in turn depends upon the determination of the following general issue:

1. Whether the petitioner is entitled to a deduction in 1943 for a loss sustained by it from the transfer of certain parcels of real estate in that year at a price below cost.

The Tax Court denied the loss on the ground that the sale of the property lacked substance and was

not a bona fide sale and therefore losses sustained therein could not be recognized as deductible losses for tax purposes. In view of the basis upon which the Tax Court rejected the petitioner's contentions, the issue might be considered to be narrowed to the question of whether the petitioner's sale of its property was a bona fide sale.

Prior to 1943 the United States Comptroller of the Currency had made a demand upon the Bank to reduce its surplus accounts by a write-down of certain parcels of its real estate, in which were located branch banks, from the value at which they were carried on the books of the Bank to their current market value. The Bank challenged the Comptroller's authority to compel such a write-down and also questioned the Comptroller's current market appraisal of the property. The Bank contended it had the legal right to carry the property at cost less reasonable depreciation.

In a settlement of the dispute, the Bank agreed that it would effect a charge-off or write-down of certain properties to an agreed market valuation provided it were permitted to do so in a manner consistent with its contentions. The Comptroller had no objection to this, so the Bank sold these parcels of property to Capital Company for cash at the appraised valuations. Capital Company then leased the properties to the Bank upon a rental basis yielding 6% per annum return to Capital Company on the price it paid for the property. Capital Company is a substantial real estate company all of whose stock is owned by Transamerica

Corporation, a holding company, who in 1943 with its subsidiaries owned about 25% of the outstanding capital stock of the Bank.

When this transfer of property was made to Capital Company, Capital Company agreed with the Bank that if the Bank wanted to repurchase the properties, Capital Company would sell the properties back to the Bank for the same price plus acquisition costs, which it had paid. The parties deliberately refrained from putting this agreement in writing.

Thirty days or so after the transfer of the property from the Bank to Capital Company, Merchants National Realty Corporation, a wholly owned subsidiary of the Bank, purchased the property from Capital Company for cash at the same price, plus acquisition costs, which Capital Company had paid for the properties.

The Bank claimed the difference between its cost of the property and the price which it had received from Capital Company as a deductible loss on its income tax return for 1943, submitting with the return an explanation of the transaction out of which the loss arose. Upon audit of the return the Commissioner of Internal Revenue disallowed the loss and the Tax Court sustained the Commissioner.

IV.

Assignment of Error

In making and rendering its decision as aforesaid, the Tax Court of the United States erred to

the prejudice of petitioner in the following respects:

1. In determining a deficiency in income and excess profits taxes for the calendar year 1943 and in failing to find that the petitioner overpaid its tax for said year.

2. In determining that the sale by petitioner of certain parcels of real estate to Capital Company lacked substance and reality and was not a bona fide sale.

3. In determining that the loss sustained by the Petitioner in the sale of said parcels of real estate to Capital Company was not deductible for tax purposes.

4. In determining that the sale by the petitioner of said real estate to Capital Company and the later sale of said real estate by Capital Company to Merchants National Realty Corporation, a wholly owned subsidiary of the petitioner, was not a transaction recognizable under the income tax laws to the extent that losses which were sustained therein could be allowed as deductions for tax purposes.

Wherefore, petitioner prays that the decision of the Tax Court of the United States be reviewed by the United States Court of Appeals for the Ninth Circuit and that a transcript of the record be prepared in accordance with the law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be

taken to the end that the errors complained of be reviewed and corrected by said Court.

/s/ GEORGE H. KOSTER,
Attorney for Petitioner.

/s/ BAYLEY KOHLMEIER,
Of Counsel.

State of California,
City and County of San Francisco—ss.

George H. Koster, being first duly sworn, on his oath says that he is attorney of record for the petitioner named in the foregoing petition for review, and as such, is duly authorized to verify said petition; that he has read said petition and knows the contents thereof; and that the statements of facts therein are true.

/s/ GEORGE H. KOSTER,
Attorney for Petitioner.

Subscribed and sworn to before me this 7th day of February, 1951.

[Seal] /s/ JOHN F. BURNS,
Notary Public in and for the City and County of San Francisco, State of Cailfornia.

My Commission Expires April 12, 1953.

Received and Filed T.C.U.S. February 9, 1951.

[Title of U. S. Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To: Honorable Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, Washington, D. C.

You are hereby notified that on February 9, 1951, a Petition for Review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax Court of the United States heretofore rendered on December 22, 1950, in the above-entitled cause was filed with the Clerk of the Tax Court.

A copy of said petition so filed is attached hereto and served upon you.

/s/ GEORGE H. KOSTER,
Attorney for Petitioner.

/s/ BAYLEY KOHLMEIER,
Of Counsel.

Affidavit of Service by Mail attached.

Received and filed T.C.U.S. February 26, 1951.

[Title of U. S. Court of Appeals and Cause.]

STATEMENT OF POINTS TO BE RELIED UPON ON APPEAL

Comes now the petitioner above named, by its attorneys of record, and states that it intends to rely on appeal on all and each of the errors assigned in the Petition for Review herein, and Petitioner hereby formally adopts the errors assigned in the Petition for Review as its Statement of Points to Be Relied Upon on Appeal.

/s/ GEORGE H. KOSTER,
Attorney for Petitioner.

/s/ BAYLEY KOHLMEIER,
Of Counsel.

Affidavit of Service by Mail attached.

Received and filed T.C.U.S. February 26, 1951.

[Title of U. S. Court of Appeals and Cause.]

DESIGNATION OF CONTENTS OF RECORD ON APPEAL

To the Clerk of the Tax Court of the United States:

You will please prepare, transmit and deliver to the Clerk of the United States Court of Appeals for the Ninth Circuit, the entire record in the above-entitled proceeding, including the transcript of statement of counsel, the stipulation of facts together with exhibits attached thereto, and all other exhibits in-

troduced at the hearing of the case, in connection with the petition for review by the said Court of Appeals heretofore filed by the above-named petitioner.

Said transcript is to be prepared as required by law and the rules of the said Court of Appeals for the Ninth Circuit.

/s/ GEORGE H. KOSTER,
Attorney for Petitioner.

/s/ BAYLEY KOHLMEIER,
Of Counsel.

Affidavit of Service by Mail attached.

Received and filed T.C.U.S. February 26, 1951.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 30, inclusive, constitute and are all of the original papers and proceedings, including Exhibits 1-A thru 22-V, on file in my office as called for by the Designation of Contents of Record on Appeal in the proceeding before the Tax Court of the United States entitled: "Bank of America National Trust and Savings Association, Petitioner, v. Commissioner of Internal Revenue, Respondent," Docket No. 8993, and in which the petitioner in the Tax Court proceeding has initiated an appeal as

above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 7th day of March, 1951.

[Seal] /s/ VICTOR S. MERSCH,
Clerk.

[Endorsed]: No. 12881. United States Court of Appeals for the Ninth Circuit. Bank of America National Trust and Savings Association, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of the Tax Court of the United States.

Filed March 19, 1951.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

[Title of U. S. Court of Appeals and Cause.]

STIPULATION AND ORDER FOR OMISSION OF CERTAIN EXHIBITS FROM PRINTED RECORD AND CONSIDERATION OF DUPLICATE COPIES THEREOF

Whereas, petitioner has served and filed its Designation of Portion of Record to be Printed, and

Whereas, there has been no dispute with regard to the facts established by two of the exhibits now designated to be printed subject to this stipulation, as Exhibits 17-Q, 18-R and 19-S, part of Document 16 of the Transcript of the Record, and being the printed Annual Reports made by Transamerica Corporation for 1943 and by Bank of America National Trust and Savings Association for 1942 and 1943, to their respective stockholders, and

Whereas, it now appears that the cost of printing said afore-mentioned exhibits will be unduly high, and

Whereas, it is believed that neither the Court nor Counsel would be inconvenienced by the omission of said exhibits from the printed record,

Now Therefore, it is stipulated and agreed by and between the parties hereto, through their respective counsel of record, but subject to the approval of the Court, that the said exhibits hereinabove described may be omitted from the printed record and that said exhibits may be referred to and considered in the consideration of the issues presented by this Appeal, provided that Counsel for petitioner shall at the time

of filing the printed record furnish three copies of each of said exhibits to the Court and one copy thereof to counsel for the respondent.

Dated this 4th day of April, 1951.

/s/ GEORGE H. KOSTER,
Attorney for Petitioner.

/s/ THERON L. CAUDLE,
Assistant Attorney General,
Attorneys for Respondent.

It is so ordered this 6th day of June, 1951.

/s/ WILLIAM HEALY,
Judge of the Court of Appeals
for the Ninth Circuit.

/s/ H. F. BONE,

/s/ WM. E. ORR,
Circuit Judges.

[Endorsed]: Filed April 6, 1951.

[Title of U. S. Court of Appeals and Cause.]

STIPULATION AS TO DESIGNATION OF RECORD TO BE PRINTED

Whereas, petitioner has filed its Statement of Points to be Relied Upon on Appeal and Designation of Portion of Record to be Printed and has requested therein that certain portions of the record certified to this Court be omitted from the printed record, and

Whereas, certain portions of the record designated by petitioner to be omitted from the printed record are portions of Exhibits not necessary to the consideration of the issues on this Appeal;

Now Therefore, It Is Stipulated by and between the parties hereto through their respective counsel of record that the following parts of the Transcript of the Record are not necessary to the consideration of the issues in this case.

1. All of document 2 of the Record being the original Petition to the Tax Court, except print Exhibit A of said Petition being the deficiency letter consisting of a one-page letter and a "Statement" of seven (7) pages.

2. All of document 3 being the Answer to the original Petition.

3. All of document 4 being a Request for designation of Place of Hearing.

4. All of document 5 being a Notice of Place of Hearing.

5. All of document 9 being a Motion for setting.

6. All of document 10 being a Notice of Hearing.

7. All of document 11 being subpoenas and applications for subpoena.

8. All of document 12 being Minutes of Tax Court proceedings.

9. (a) That part of document 16 consisting of Exhibits 17-Q, 18-R and 19-S which are to be

omitted pursuant to Stipulation filed concurrently with this designation, if the Stipulation is approved by the Court.

(b) All of that part of document 16 consisting of Exhibit 21-U, being the Bank of America N.T. & S.A income and excess profits tax returns on Forms 1120 and 1121, except print the following parts of the Form 1120:

Pages 1 and 4 of said Form 1120;

The schedule attached to said return headed, "Bank of America N.T. & S.A 1943 Schedules (Cont'd)" and containing schedule of "Other Earnings—Line 14," "Gain and Losses from Sale Non-capital Assets—Line 12(b), "Bad Debts—Line 20" and "Taxes—Line 22";

The schedule attached to said return headed, "Bank of America N.T. & S.A. 1943 Schedules (Cont'd)" and containing schedule of "Other Deductions—Line 29," and "Depreciation—Line 25";

The schedule attached to said return headed, "Explanatory Statement as to Losses Included in Losses Reported in Schedule D";

(c) All of that part of document 16 consisting of Exhibit 22-V being the Merchants National Realty Corporation income and excess profits tax returns on Forms 1120 and 1121, except print the following parts of said returns:

Pages 1 and 4 of said Form 1120;

Pages 1 and 2 of said Form 1121;

The schedule attached to the said return Form 1120 headed, "Merchants National Realty Corp.—1943 Schedules," and containing schedules of "Gains & Losses, Sale of Non-Capital Assets—Line 12-B," "Other Income—Line 14," "Taxes—Line 22," "Losses—Line 24," "Depreciation—Line 25," "Other Deductions—Line 29," Statement of Affiliation—Q-9, and Statement of Salary Adjustments—Q-11.

10. All of document 18 being the Brief for Petitioner.

11. All of document 19 being the Opening Brief for Respondent.

12. All of document 20 being the Petitioner's Reply Brief.

13. All of document 21 being the Reply Brief for Respondent.

14. All of document 23 being the Respondent's Computation for Entry of Decision.

15. All of document 24 being Notice Under Rule 50.

16. All of document 25 being Minutes of Tax Court proceedings.

It is further stipulated and agreed that if, in the course of preparation of their briefs or in the argument of this Appeal, either party finds it necessary or desirable to refer to any of the exhibits

omitted from the printed record, he may, with the permission and approval of the Court, refer to said exhibits in the original record.

It is further stipulated and agreed that this stipulation may be made a part of the Record and be included in the printed record.

Dated this 4th day of April, 1951.

/s/ GEORGE H. KOSTER,
Attorney for Petitioner.

/s/ THERON L. CAUDLE,
Asst. Attorney General,
Attorneys for Respondent.

[Endorsed]: Filed April 6, 1951.

[Title of U. S. Court of Appeals and Cause.]

STATEMENT OF POINTS TO BE RELIED UPON ON APPEAL AND DESIGNATION OF PORTION OF RECORD TO BE PRINTED

Comes now the petitioner above named by its attorneys of record and states that it intends to rely on appeal on all and each of the errors assigned in the Petition for Review herein, which Petition for Review is included in the transcript herein, and petitioner formally adopts the errors assigned in said Petition for Review as its Statement of Points to be Relied upon on Appeal.

Petitioner further states that it believes that only the portions of the Transcript of the Record designated below to be printed, are necessary for the consideration of the errors assigned and relied upon by petitioner. Petitioner therefore requests that only the following portions of the said Transcript of the Record certified to this Court be printed:

1. Document 1 being Docket Entries.

2. Only that part of document 2, Original Petition to Tax Court, which consists of Exhibit "A" and "Statement" of seven (7) pages attached thereto.

3. Documents 6, 7 and 8 being Motion for Leave to File Amended Petition, Amended Petition, and Answer to Amended Petition.

4. Documents 13 and 14 consisting of Motion for Leave to File Amendment to Answer, and Amendment to Answer.

5. Document 15 being Stipulation of Facts with Exhibits 1-A through 6-F and 7-G through 16-P.

6. Only that part of document 16 consisting of Exhibits 17-Q through 22-V which is not hereinafter designated as parts to be omitted.

7. All of document 17 being the Transcript of Hearing.

8. All of document 22 being Finding of Fact and Opinion.

9. All of document 26 being the Decision.

10. All of documents 27 to 30 being the Petition for Review, Notice of Filing Petition for Review, Statement of Points to be Relied Upon on Appeal, Designation of Contents of Record on Appeal.

11. Certificate and Seal of Tax Court Clerk.

12. Stipulation for Omission of Certain Exhibits from Printed Record and Consideration of Duplicate Copies Thereof, and Order of Court thereon.

13. Stipulation as to Designation of Record to be Printed.

14. This Statement of Points to be Relied Upon on Appeal and Designation of Points of the Record to be Printed.

Petitioner requests that the following portions of the Transcript of the Record be omitted from the printed record:

1. All of document 2 of the Record being the original Petition to the Tax Court except print Exhibit A of said Petition being the deficiency letter consisting of a one-page letter and a "Statement" of seven (7) pages.

2. All of document 3 being the Answer to the original Petition.

3. All of document 4 being a Request for Designation of Place of Hearing.

4. All of document 5 being a Notice of Place of Hearing.

5. All of document 9 being a Motion for Setting.

6. All of document 10 being a Notice of Hearing.

7. All of document 11 being subpoenas and applications for subpoena.

8. All of document 12 being Minutes of Tax Court proceeding.

9. (a) That part of document 16 consisting of Exhibits 17-Q, 18-R and 19-S which are to be omitted pursuant to Stipulation filed concurrently with this designation, if the Stipulation is approved by the Court.

(b) All of that part of document 16 consisting of Exhibit 21-U, being the Bank of America N.T. & S.A. income and excess profits tax returns on Forms 1120 and 1121, except print the following parts of the return Form 1120:

Pages 1 and 4 of said Form 1120;

The schedule attached to said return headed, "Bank of America N.T. & S.A. 1943 Schedules (Cont'd)" and containing schedule of "Other Earnings—Line 14," "Gain and Losses from Sale Non-capital Assets—Line 12(b), Bad Debts—Line 20" and "Taxes—Line 22."

The schedule attached to said return headed "Bank of America N.T. & S.A 1943 schedules (Cont'd)" and containing schedule of "Other Deductions—Line 29," and "Depreciation—Line 25."

The schedule attached to said return headed, "Explanatory Statement as to Losses Included in Losses Reported in Schedule D."

(c) All of that part of document 16 consisting of Exhibit 22-V being the Merchants National Realty Corporation income and excess profits tax returns on Forms 1120 and 1121 except, print the following parts of said returns:

Pages 1 and 4 of said Form 1120;

Pages 1 and 2 of said Form 1121;

The schedule attached to the said return Form 1120 headed, "Merchants National Realty Corp.—1943 Schedules," and containing schedules of "Gains & Losses, Sale of Non-Capital Assets—Line 12-B," "Other Income—Line 14," "Taxes—Line 22," "Losses—Line 24," "Depreciation—Line 25," "Other Deductions—Line 29," Statement of Affiliation—Q-9, and "Statement of Salary Adjustments—Q-11."

10. All of document 18 being the Brief for Petitioner.

11. All of document 19 being the Opening Brief for Respondent.

12. All of document 20 being the Petitioner's Reply Brief.

13. All of document 21 being the Reply Brief for Respondent.

14. All of document 23 being the Respondent's Computation for Entry of Decision.

15. All of document 24 being Notice Under Rule 50.

16. All of document 25 being Minutes of Tax Court proceedings.

Dated this 4th day of April, 1951.

/s/ GEORGE H. KOSTER,
Attorney for Petitioner.

/s/ THERON L. CAUDLE,
Asst. Attorney General,
Attorneys for Respondent.

[Endorsed]: Filed April 6, 1951.

No. 12,881

IN THE

United States Court of Appeals

For the Ninth Circuit

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,
Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Appellee.

APPELLANT'S OPENING BRIEF.

GEORGE H. KOSTER,
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Of Counsel.

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No. 12,881

IN THE

United States Court of Appeals

For the Ninth Circuit

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, *Appellant*, vs. COMMISSIONER OF INTERNAL REVENUE, *Appellee*.	

APPELLANT'S OPENING BRIEF.

JURISDICTIONAL STATEMENT.

This is an appeal from a decision of The Tax Court of the United States in which a deficiency in income taxes was determined against the Appellant Bank for the year 1943. The findings of fact and opinion below are reported in 15 T.C. 544 (Adv. No. 74), and are set forth in full in the record herein. (R. 119.)

Appellant Bank is a national banking association which was incorporated on March 1, 1927 under the laws of the United States, and maintains its principal office in San Francisco, California. (R. 7, 23.) Appellant filed its 1943 income tax returns with the Collector of Internal Revenue for the First District of California at San Francisco, California. (R. 8, 23.)

Appellee, the Commissioner of Internal Revenue, determined a deficiency in said Bank's income taxes for the year 1943 and on June 5, 1945, pursuant to Section 272 of the Internal Revenue Code, sent to the said Bank a notice of said deficiency. (R. 8, 23.) The said Bank filed its appeal to The Tax Court of the United States pursuant to Section 272 of the Internal Revenue Code and thereafter duly filed an Amended Petition with said Court. (R. 3.) The said Commissioner of Internal Revenue duly filed his Answer to said Petitions. (R. 3.) The appeal was heard on November 7, 1949, and the case was submitted upon the introduction of a Stipulation of Facts and documentary evidence. On October 20, 1950, The Tax Court promulgated its findings of facts and Opinion (R. 5, 119), and on December 22, 1950, the decision of The Tax Court determining a deficiency in tax against said Bank was entered. (R. 5, 143.)

On February 9, 1951, under authority of Sections 1141 and 1142 of the Internal Revenue Code (Title 26 U. S. Code, Sections 1141 and 1142), the Appellant Bank filed its petition for review by this Court of said decision of The Tax Court of the United States. (R. 145.) This appeal and the transcript of record herein were duly filed and docketed in this Court on March 19, 1951. (R. 155.)

STATEMENT OF THE CASE.

The controversy herein involves the correct income tax liability of the Appellant Bank for the year 1943, which in turn involves the question of whether a loss

resulting from the sales of certain parcels of real estate in that year is deductible from gross income for income tax purposes. The Tax Court concluded that the sales were not *bona fide* sales with a complete termination of the Bank's interest in the properties so the loss was not allowable. In view of The Tax Court's conclusion, the issue is narrowed to the question of whether the sales of the properties by the Bank were *bona fide* sales recognizable as such for tax purposes.

The facts were stipulated and will be analyzed hereinafter in detail, but for purposes of this Statement the following summary will present a fair introduction to the case.

Prior to 1943 the United States Comptroller of the Currency had made a demand upon the Bank to reduce its surplus accounts by a write-down of certain parcels of its real estate, in which were located branch banks, from the value at which they were carried on the books of the Bank to their current market value. The Bank challenged the Comptroller's authority to compel such a write-down and also questioned the Comptroller's current market appraisal of the property. The Bank contended it had the legal right to carry the property at cost less reasonable depreciation.

In a settlement of the dispute, the Bank agreed that it would effect a charge-off or write-down of certain properties to an agreed market valuation provided it were permitted to do so in a manner consistent with its contentions. The Comptroller had no objection to this, so the Bank sold these parcels of property to

Capital Company for cash at the appraised valuations. Capital Company then leased the properties to the Bank upon a rental basis yielding 6% per annum return to Capital Company on the price it paid for the property. This rental was reported by Capital Company as income, and by the Bank as expense, for income tax purposes. Capital Company is a substantial real estate company all of whose stock is owned by Transamerica Corporation, a holding company, who in 1943 with its subsidiaries owned about 25% of the outstanding capital stock of the Bank.

When this transfer of property was made to Capital Company, Capital Company agreed with the Bank that if the Bank wanted to repurchase the properties, Capital Company would sell the properties back to the Bank for the same price plus acquisition costs, which it had paid. The parties *deliberately* refrained from putting this agreement in writing.

Thirty days or so after the transfer of the property from the Bank to Capital Company, Merchants National Realty Corporation, a wholly owned subsidiary of the Bank, purchased the property from Capital Company for cash at the same price, plus acquisition costs, which Capital Company had paid for the properties.

The Bank claimed the difference between its cost of the property and the price which it had received from Capital Company as a deductible loss on its income tax return for 1943, submitting with the return an explanation of the transaction out of which the loss arose. Upon audit of the return the Commissioner

of Internal Revenue disallowed the loss and The Tax Court sustained the Commissioner.

The Tax Court held that the sale to Capital Company was not a *bona fide* sale, that "Capital was merely a conduit for the passage of title to the eight bank properties from petitioner to Merchants" and "Capital was obligated to deliver deeds—back to petitioner or Merchants, and the parties never intended, under any circumstances, that Capital should retain title to any of the eight properties," (R. 138) so "the sale must be viewed as being made between petitioner as vendor and Merchants as vendee." (R. 139.) Consequently, The Tax Court ruled that there could be no recognizable loss on the transfer of the properties to Capital Company. As to the transfer of the properties to Merchants, The Tax Court concluded that no loss could be recognized because, "There is no substance to the sale of the branch banks by petitioner to its wholly owned subsidiary" and "Petitioner had complete domination and control over Merchants, and the properties in the hands of Merchants were as much subject to petitioner's control as they were while legal title was in petitioner's own name." (R. 142-143.)

The Appellant Bank contends that The Tax Court erred in its conclusions, that the sales were *bona fide* and were intended to be *bona fide,* and that the loss resulting from the sales is properly deductible under the Internal Revenue Code. The Appellant Bank believes the sale to Capital Company must be recognized as a *bona fide* sale and that the loss resulting there-

from is deductible from gross income; but even if the transaction is construed as a sale from the Bank to Merchants, the mere fact that the Bank has domination and control over its wholly-owned subsidiary, is not valid justification for the disallowance of the loss resulting from the sale.

STATUTE INVOLVED.

Internal Revenue Code:

Section 23(f) Losses By Corporations.—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

Section 111(a) Determination of Amount of, and Recognition of Gain or Loss.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(c) *Recognition of Gain or Loss.*—In the case of a sale or exchange the extent to which the gain or loss determined under this section shall be recognized

for the purposes of this chapter, shall be determined under the provisions of section 112.

Section 112. RECOGNITION OF GAIN OR LOSS.

(a) GENERAL RULE.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(None of the exceptions contained in Section 112 are applicable.)

There is no dispute as to the adjusted basis under Section 113 of the property sold by Appellant Bank, nor is there any dispute that the loss if deductible is a loss from the sale of assets other than capital assets under Section 117(j), so there is no need to transcribe any provisions of the Internal Revenue Code other than those quoted above.

ASSIGNMENTS OF ERROR.

The following are the assignments of error as set forth in the Petition for Review (R. 149-150):

In making and rendering its decision as aforesaid, The Tax Court of the United States erred to the prejudice of petitioner in the following respects:

1. In determining a deficiency in income and excess profit taxes for the calendar year 1943 and in failing to find that the petitioner overpaid its tax for said year.

2. In determining that the sale by petitioner of certain parcels of real estate to Capital Company

lacked substance and reality and was not a bona fide sale.

3. In determining that the loss sustained by the petitioner in the sale of said parcels of real estate to Capital Company was not deductible for tax purposes.

4. In determining that the sale by the petitioner of said real estate to Capital Company and the later sale of said real estate by Capital Company to Merchants National Realty Corporation, a wholly-owned subsidiary of the petitioner, was not a transaction recognizable under the income tax laws to the extent that losses which were sustained therein could be allowed as deductions for tax purposes.

SUMMARY OF ARGUMENT.

The Appellant argues that The Tax Court was wrong in concluding (1) that the sale from the Bank to Capital Company was not *bona fide,* (2) that Capital Company was a mere conduit for transfer of title to Merchants and that the Bank never relinquished dominion and control of the property which it sold, (3) that the transaction was in reality a sale of property by the Bank to Merchants, (4) that no loss was sustained or could be recognized for tax purposes on the sale to Capital Company, (5) that the Bank's dominion and control was sufficient to justify a disregard of any tax consequences on transactions between the Bank and Merchants, and (6) assuming the transaction to be a sale by the Bank to Merchants,

that no loss was sustained or could be recognized for tax purposes on the sale to Merchants.

In general, the Appellant predicates its argument upon two factors:

(1) That the parties intended the sale to Capital Company to be a *bona fide*, closed and completed transaction, separate and distinct from any later resale of the property by Capital Company, and

(2) That the transactions involved in this case were not intended or executed for the purpose of, or as a means of, tax avoidance.

The argument will show that the test of deductibility of losses sustained upon the sale of property depends upon the intention of the parties to the sale as to whether the sale was to be a real *bona fide* sale. If the sole purpose of the transaction or series of transactions from which the loss alleged to have been sustained is to create a tax loss and avoid a tax, the sale transaction or other transactions by which this is accomplished are considered to be merely pretended sales or transactions and therefore unrealistic or a sham. The cases reach this conclusion by implying the tax avoidance purpose as the sole intent of the entire transactions. In other words, the Courts say that whatever the mechanics employed, the intent throughout was that these mechanics were to be in substance merely a means for accomplishing a tax avoidance regardless of their form and so the intention was not to complete a transaction which might be indicated by the form employed, but merely to secure or accomplish a tax avoidance. The Courts say

that without the intent to take the consequences of a *bona fide* transaction according to its form, such a transaction cannot be recognized for tax purposes. This philosophy and principle of construction of transactions for tax purposes applies similarly in cases where there is a sale and an agreement to repurchase where throughout the entire transaction the only intent was to ultimately accomplish a tax avoidance.

If the tax avoidance scheme is absent, a transaction must necessarily be given its effect according to its form because whatever the purpose might be, the intent must necessarily have been that the transaction in form should be effected to reach the intended objective. Where the tax avoidance scheme is absent, the Courts will recognize intent and purpose as separate and distinct factors and in such instances the purpose will not be applied to vitiate the intent with respect to the transactions employed to reach the desired purpose. *There is no case* where a sale was made for a purpose other than to accomplish a tax avoidance in which it was held that the sale was to be disregarded, even though there might have been a subsequent transaction no matter how close in point of time to the original sale transaction.

In this case the purpose of tax avoidance was absent. The sale by the Bank to Capital Company was made for the sole and exclusive purpose of settling a controversy with the Comptroller of the Currency in a manner which the Bank considered important to avoid establishing any precedent which might later be detrimental to it. The settlement of the controversy

in the manner described was the purpose of the transaction; the intent of the Bank and Capital Company was that the sale should be a closed and completed transaction and that at least for a period of time the sale should be so effective as to divest the Bank of all title and control of the property and to vest that complete title and control in Capital Company as the owner of the property; the intent had to comprehend such a result because it was only by such a transaction having such consequences that the Bank could accomplish its purpose, and be able to support its position that it did not make a mere paper transaction or write-down of assets but actually suffered a loss through a sale of property; the purpose of the arrangement with respect to the possible repurchase of the property was to have an understanding with Capital Company that the Bank could repurchase the property when and if it desired to do so, but the intent behind this repurchase understanding was that it should have no effect upon the original sales transaction and that it should have no legal or binding effect as an encumbrance on Capital Company's ownership of the property because again the ultimate purpose of avoiding precedent which might be detrimental to the Bank in the future required that there be no transaction which might alter the legal effect of the original sale.

The statute (Section 112) requires nothing more than that the cost shall exceed the selling price in order that there be a determination of loss from the sale of property. The question of intent, of realism,

arises from principles established by case authority in applying the statute, and these principles were devised to prevent the deduction of losses from unrealistic transactions made solely for the purpose of defeating the revenue. It is respectfully submitted that in this case there was a sale from the Bank to Capital Company and the selling price was less than the cost of the property sold so that a loss was sustained by the Bank when the sale was made. The element of tax avoidance is not present so there is nothing to bring into play the principles devised to prevent tax avoidance.

In this case there was a later sale by Capital Company to Merchants, but before that sale was made, Capital Company was the owner of the property, in complete control of title and income, which income was included by it in its income tax returns and subjected to tax; and Capital Company was bound by nothing more substantial than a moral commitment made with the Bank to resell the property to the Bank at its request, which commitment was made with the deliberate understanding that it was to be merely a moral commitment and not a legal and binding obligation, and so again the agreement for resale was not such a reserved power as to have the legal effect of vitiating the original sales transaction and the legal consequences thereof, nor did it have the effect of vitiating Capital Company's ownership of the property from the time it purchased until the time it sold. The very intent of the parties was that the repurchase arrangement should not have any effect upon the

original sales transaction. There is no basis whatever under the foregoing analysis of the principles pronounced in the cases on the subject, for disregarding the sale from the Bank to Capital Company and the consequences of such sale under the tax statutes. The loss was sustained. There is no restriction against its allowance as a deduction under the statute so it should be allowed.

The Tax Court's disregard of the sale to Capital Company and its consequent construction of the transaction as a sale from the Bank to Merchants is in direct contravention of the intent and purpose of the Bank, as hereinbefore stated, and in absolute conflict with the facts which show that the Bank deliberately refrained from selling to Merchants. The Court cannot impose upon a taxpayer a transaction which it did not make.

It is the Appellant's view that the sale of its property to Capital Company must be recognized and that the loss sustained upon that sale must be allowed. Under this view of its case, the later sale by Capital Company to Merchants is of no consequence in a determination of the issue involved herein. However, since The Tax Court took the position that the sale should be construed as a sale from the Bank to Merchants, it is necessary to submit some discussion of the case on that premise since the Appellant believes that even on that premise The Tax Court erred in refusing to allow a deduction for the loss sustained in the sale.

If the sale is to be treated as a sale by the Bank to Merchants, the sale has to be recognized as a completed

transaction and the loss resulting therefrom must be allowed as a deduction. Mere domination and control through stock ownership or other arrangement, other than possibly a strict and irrefutable agency arrrangement which does not exist in this case, is not sufficient in the absence of any scheme for tax avoidance, to justify a disregard of a transaction between a parent and its subsidiary or the tax consequences thereof. The lease arrangement between the Bank and Merchants, existing since 1936 was not any more unusual than arrangements discussed by the Courts in cases in which it was held that such arrangements would not justify a disregard of the corporate entities or transactions between them. There is no statutory provision or legal authority which would support the refusal to allow as a deduction a loss sustained by the Bank on a sale of property to Merchants.

ARGUMENT.

I. INTRODUCTORY STATEMENT.

The relationship between the parties to the sales transactions involved in the proceeding is of primary importance in the determination of whether The Tax Court is right or wrong in its decision, so the following explanation is given to identify these parties and their participation in the sales transaction.

Bank of America N.T. & S.A.

This Bank is the Appellant, the taxpayer who made the sale of eight properties in 1943 from which a loss resulted, and it is the deductibility of this loss which is involved in this proceeding.

The Bank operates a banking system in California through approximately 500 branches. (R. 121.) Title to some of the buildings in which it conducts its banking business is held by it, and title to others is held by Merchants National Realty Corporation. (R. 121.) The properties owned by Merchants are leased to the Bank. (R. 122, 38, 72.) The eight properties which the Bank sold to Capital Company were properties in which the Bank was operating branches. (R. 34, 37.) After the sale the Bank leased these properties from Capital Company. (R. 38.) Later, Capital Company sold the properties to Merchants National Realty Corporation, after which time the Bank leased the properties from Merchants. (R. 34-35, 38.)

Merchants National Realty Corporation.

Merchants was a wholly owned subsidiary of the Bank. (R. 38.) Many of the officers and directors of the Bank were officers and directors of Merchants. (R. 38.) Merchants had no salaried employees. (R. 38.) Whatever work was necessary to the operation of its business was performed by employees of the Bank. (R. 38.) The only business of Merchants was the ownership of property which it leased to the Bank, under a lease arrangement, which has been in effect since 1936, whereby the Bank paid a rental to Merchants equal to the net expenses and charges of Merchants allowable as deductions from gross income for income tax purposes. (R. 38, 72.) During 1943, Merchants incurred and paid expenses of over $380,000.00. (Ex. 22-V, R. 110) and at December 31, 1943, it had

assets of over $19,200,000.00 and a net worth of over $18,900,000.00, as disclosed by its balance sheet as of that date. (Ex. 22-V, R. 111.)

About 30 days or so after the Bank sold the eight parcels of property to Capital Company as hereinbefore mentioned, Merchants purchased the properties from Capital Company for cash at the same price that Capital Company had paid for them, plus acquisition costs. After Merchants purchased the properties they were leased to the Bank under the general lease arrangement described in the preceding paragraph hereof.

Capital Company.

Capital Company is a substantial real estate company with a net worth of approximately $33,250,000.00 and total assets represented mostly by real estate, of $37,100,000.00. (R. 35, Ex. 18-R, pp. 8, 20-21.) It is a wholly owned subsidiary of Transamerica Corporation. (R. 39.) Transamerica Corporation with its subsidiaries owned about 22% of the outstanding capital stock of the Bank in 1943. (R. 40.) In 1943 Capital Company purchased the said eight properties from the Bank for cash at a price equal to the appraised value of the properties. (R. 35, 36.)

After acquiring the properties, Capital Company leased them back to the Bank under a written lease agreement covering each property and providing in general for a rental payment to yield 6% net to Capital Company on its investment in the property. (R. 36, 38.)

After Capital Company had held the properties for about 30 days it sold them to Merchants for cash for an amount equal to the cost of the properties to it. (R. 36.)

II. NEITHER THE FACTS NOR THE LAW JUSTIFY THE TAX COURT'S CONCLUSION THAT THE SALES TO CAPITAL COMPANY WERE NOT BONA FIDE.

The Tax Court refused to recognize the sale from the petitioner Bank to Capital Company as a *bona fide sale* even though the Court found that, "The facts show that petitioner conveyed the legal title to the properties to Capital Company, and that it meticulously complied with all of the customary formalities necessary for the transfer of title." (R. 134.) The Court based its decision that the sale to Capital Company could not be recognized for tax purposes on the conclusion that, "Petitioner never relinquished dominion or control over the eight properties to Capital. Petitioner intended only a temporary vesting of title in Capital, and it was assured of its ability to recover the properties under its oral agreement with Capital." (R. 137.)

It is true that petitioner "intended only a temporary vesting of title in Capital", but it is indisputable that the petitioner also intended that while Capital owned the property it was to have complete and unencumbered ownership free of any dominion or control of the petitioner. The oral understanding between the Bank and Capital Company that the Bank intended to repurchase the property at some later date and

that Capital Company would resell the property to the Bank upon its request was reached with the further specific understanding that it was not to be in writing (R. 36), which was a deliberate acknowledgment by the parties that the Bank's expression of intent was not to be regarded as a legally enforceable obligation either upon the part of the Bank or upon the part of Capital Company.

The very essence, purpose and objective of the transaction was to take the properties out of the dominion and control of the Bank, actually and legally, for at least a limited period. It was only by such a transaction that the Bank in its opinion, could meet the Comptroller's requirement that there be a charge-off, and at the same time be in a position (1) to maintain that the charge-off represented a loss from a sale and not a mere write-down, and (2) to maintain at any future time that the Bank never receded by word or deed from its position that the Comptroller had no authority to require a write-down of its cost of banking premises other than for normal depreciation.

The Court may have a right to refuse to give effect for tax purposes to a valid transaction where the sole purpose of the transaction was to avoid taxes, or where the transaction was a sham because of the intent to avoid taxes, but there is absolutely no authority which permits the Court to disregard a valid and completed transaction, or to declare it lacking in bona fides, *where it was effected to accomplish a purpose which had no relationship to tax results.* In this connection, the stipulation of facts filed in this proceed-

ing requires careful analysis. As The Tax Court stated in its opinion (R. 134), "all of the facts in this proceeding have been stipulated, and they are not in dispute. In fact, *the petitioner has not concealed at any time any of its arrangements, but has made full disclosures of them,* at least as far as this proceeding is concerned," (See also Opening Statement of Government Counsel, R. 43-60) so every effort has been made to present to the Court not only what the parties did but also what they were thinking about and what they intended when they did it.

The Bank presents its position thus,—It made a sale of property for the purpose of sustaining a position it was maintaining in a controversy with the Comptroller of the Currency; it intended to repurchase the properties within a period of 30 days or so, but it wanted no binding agreement or commitment to that effect because it could not accomplish the purpose just stated unless the sale was complete and effective; it explained this to Capital Company when offering Capital Company the property so that there could be no misunderstanding about the deal; every formality was complied with to protect Capital Company as the owner of the property; although Capital Company said they would resell to the Bank if the Bank offered to repurchase, it was understood and agreed that the promise to resell was not to be a legally binding agreement, and it was obvious of course that until resale, Capital Company had all the benefits and burdens of ownership including any risk of loss in case of disaster; it (the Bank) made this sale for the sole and

exclusive purpose above stated and its only concern about income taxes was that it did not want to get into trouble with the income tax Bureau because of the fact that the resultant tax benefit from the loss on the sale might make it appear that it had entered into this transaction to avoid a tax; the question of affecting tax liability had nothing whatever to do with its decision to make the sale; the sale of the property was a real sale and intended as such and since the tax laws allow deductions for losses sustained in such sales, the loss claimed in this proceeding should be allowed.

(a) The Stipulation Shows Conclusively That the Sales Transactions Were Entered Into Solely for the Purpose of Effecting a Settlement of a Controversy With the Comptroller.

The stipulation (R. 31-41) shows the following: Paragraphs 1 to 4 inclusive (R. 32-34) describes the Bank's controversy with the Comptroller of the Currency about his demand that the Bank make a write-down of its Banking premises account and make a charge-off to its undivided profits account accordingly; they explain the Bank's position that the Comptroller had no authority to require such a write-down and further that the banking premises were worth the figure at which they were being carried on the books (See especially Exs. 1-A and 4-D attached to the Stipulation, R. 61, 66); they show that the settlement of the controversy was made upon the understanding that the Bank would effect the agreed-upon charge-off by a transaction which would establish a new cost basis on the properties on which the charge-offs were to be

made; *and as stated in paragraph 4 of the stipulation, "and, when the Bank agreed with the Comptroller to reduce its banking premises account in order to settle the issue with the Comptroller, it did so in the manner stated below to which the Comptroller had no objection."* (R. 34.)

Paragraph 5 of the Stipulation then opens with the statement, *"On account of the foregoing, the following transactions were effected"* (R. 34) and then follows a description of the sales transactions involving the sales of the banking properties from the Bank to Capital Company and later from Capital Company to Merchants. It is obvious that the stipulation establishes that the sales transactions were made "in order to settle the issue with the Comptroller" and "on account of the foregoing," the foregoing being the controversy with the Comptroller. *This stipulation leaves no room for any inference or argument that the sales transactions were entered into for tax purposes or for any purposes other than to effect a settlement of the controversy with the Comptroller.*

The Tax Court did say in its opinion that, "The evidence shows that possible tax advantages were an important consideration in arriving at the complicated form in which the simple requirement of the Comptroller was met." (R. 140.) However, The Tax Court might have doubted this because it immediately follows the statement with the assertion, "However, the ground for this decision is not whether or not the intent to effect a tax saving was the dominant purpose of petitioner." (R. 140.)

In order to avoid the chance that this Court might reach the same misunderstanding of the facts as The Tax Court did, attention is directed to the composition of the stipulation. As hereinbefore stated, the last sentence of paragraph 4 (R. 34), and the first sentence of paragraph 5 (R. 34) of the stipulation show that the *sole purpose* of the transaction was to effect the settlement with the Comptroller. The stipulation contains a paragraph in paragraph 5 as follows (R. 36):

> "The transactions described in sub-paragraph (a), (b) and (c) above were effected pursuant to and in accordance with this agreement. When these transactions were under contemplation, the Bank's officers were advised by the Bank's counsel that these transactions might result in a large deductible loss for income tax purposes. The Bank's officers thereupon instructed the Bank's counsel to make adequate disclosure of the transactions on the tax return so that the Internal Revenue Bureau would be fully informed thereof. The Counsel's memorandum of his discussion of the matter with the Bank officials is attached hereto as Exhibit 14-N."

The explanatory statement attached to the return pursuant to the instructions mentioned in the foregoing quotation is consistent with the stipulation that the sales were made solely to meet the Comptroller's requirements, and reads as follows (R. 108):

"Explanatory Statement as to Losses Included in Losses Reported in Schedule D.

The Comptroller of the Currency insisted that the cost less depreciation of certain properties owned by this bank exceeded its present value and that a charge-off had to be made to reduce the cost to present value. In order to accomplish this in a manner consistent with the Bank's policy and contention that its properties should be carried as cost (less reasonable allowance for current depreciation), it sold these properties to Capital Company. The selling price was fixed at the present value of the property and Capital Company paid the selling price in cash. At a later date Merchants National Realty Corporation, a wholly owned subsidiary of the Bank, purchased these properties from Capital Company, for cash, for the same price at which Capital Company had purchased them. The loss resulting from this sale is claimed on this return since the Income Tax Statute contains no provisions exempting either gain or loss from such a transaction from being included in computing net income. Furthermore, this loss should be deductible in any event as a loss, because it was taken in compliance with a requirement of the Comptroller of the Currency."

The Counsel's memorandum of his conference with Bank officials (Ex. 14-N, R. 91) shows that he was consulted at a time when a settlement of the controversy was imminent, and for the sole purpose of giving advice as to how the settlement could be effected in a manner consistent with the position which the Bank

was maintaining throughout the controversy. As shown in the memorandum, the only reason the matter of taxes was discussed was that the officers of the Bank were concerned whether the Income Tax Bureau might think that this unusual transaction was entered into as a scheme to defraud the Government out of taxes, and thus cause trouble for the Bank. (The memorandum shows, "The officers of the Bank inquired as to the results of such transactions for tax purposes and especially whether there was anything wrong in transactions such as this." (R. 93); also, "The Bank officers have asked me that I should instruct them as to the method of carrying out these transactions for the purposes indicated, and that I should be careful that the transactions should be properly disclosed so that there could be no misunderstanding of the transactions, or so that there could be no complaint on the part of the tax authorities that these transactions were made for the purpose of defrauding the Government or were not properly disclosed." (R. 94.) The postscript on the memorandum shows merely that the plan for working out the settlement was discussed with officials of the Comptroller's Office, who were told that it might have some effect upon tax liabilities and these officials stated in effect that they were unconcerned about the matter of taxes. (R. 95.) This does not indicate that the transactions were entered into for tax purposes,—it shows merely that the Bank wanted to be careful that by getting out of the trouble with the Comptroller's Office, it was not getting into trouble with anybody else, and it wanted to make full dis-

closure of any possible extraneous effects which might be caused by the settlement program.

The stipulation is conclusive as hereinbefore pointed out, that the only purpose of the sales transactions was to complete a settlement of the controversy with the Comptroller in a manner consistent with the position which the Bank had maintained throughout the controversy, and the effect of the transaction on the tax liability of the Bank was merely an incident of and not a purpose of, the transactions.

(b) The Stipulation Shows Conclusively That the Bank Sold Eight Parcels of Property to Capital Company in 1943.

Paragraphs 5 and 6 of the Stipulation (R. 34-38) show as The Tax Court stated "* * * that petitioner conveyed the legal title to the properties to Capital, and that it meticulously complied with all of the customary formalities necessary for the transfers of title" (R. 134) and further that in carrying out the sales transactions, "all formalities in connection therewith * * * were complied with * * *." (R. 131.) These paragraphs show that the properties were sold by the Bank to Capital Company for cash at a price equal to the appraised value of the properties. Paragraph 5(c) (R. 35-36) explains that just prior to the sale an officer of the Bank talked to an officer of Capital Company, explained to him the Bank's controversy with the Comptroller, and reached an agreement with him which in effect was as follows:

That the Bank would sell and Capital Company would purchase the eight parcels of property for cash

at a price equal to the appraised value of the property; that the Bank intended to and would repurchase the property within 30 days or so and Capital Company would resell the property to the Bank or to Merchants upon request of the Bank for cash at a price equal to the price paid by Capital Company plus acquisition costs, but there would be no written agreement between the Bank, Merchants and Capital Company concerning the resale or repurchase (R. 36); that after the purchase of the property by Capital Company the Bank would rent the property and pay a net rental therefor equal to a 6% return per annum to Capital Company on its investment in the property. (R. 36.)

The sales by the Bank to Capital Company were consummated pursuant to this agreement (R. 36), and all formalities incidental to the transaction, including the execution of a formal lease between the Bank and Capital Company with respect to each property, were complied with. (Paragraph 6, R. 37-38, Ex. 10-J, R. 81.) The rentals received by Capital Company under these leases were reported as rental income by Capital Company for income tax purposes, and were reported as rental expense by the Bank for income tax purposes. (R. 38.)

It is obvious from the foregoing description of the facts set forth in paragraphs 5 and 6 of the Stipulation, that the transaction between the Bank and Capital Company differs from a straight out-and-out sales transaction in only one particular, and that is that at the time of the sale the Bank told Capital Company

that it would like to repurchase, and intended to repurchase the property within a short period of time, and Capital Company told the Bank that whenever it wanted to repurchase Capital Company would resell the property to it, *and at the same time both parties agreed that they would not reduce this understanding to writing.* It was primarily because of this repurchase arrangement and the later sale by Capital Company to Merchants that The Tax Court concluded (1) that the sale was a sham, (2) that the Bank never intended to relinquish, nor did it relinquish, dominion and control over the properties, and (3) that Capital Company was a mere conduit for transferring the property to Merchants. Each and all of these conclusions are wrong and are not supported by the facts as stipulated, or by any applicable statutory provision, or by any principle or rule of construction pronounced or established by Court decision.

(c) The Tax Court Was Wrong in Concluding That the Sale to Capital Company Was a Sham. There Is No Support in the Facts or in the Law for Such a Conclusion.

The Tax Court refers to *Higgins vs. Smith,* 308 U. S. 473, *Gregory vs. Helvering,* 293 U. S. 465, *Burnet vs. Huff,* 288 U. S. 156, *Weiss vs. Wiener,* 279 U. S. 333, in support of its conclusion that the sale from the Bank to Capital Company was a sham and not *bona fide.*

The *Burnet vs. Huff* and the *Weiss vs. Wiener* cases stand for the proposition that a loss to be deductible must be actual and present. They recognize that a loss

resulting from a sale is an actual and present loss, so the cases are of no help in the determination of the real issue in this case—whether the sales to Capital Company (or to Merchants) should be recognized for tax purposes.

The *Gregory vs. Helvering* and the *Higgins vs.* Smith cases are pertinent but they do not authorize the disregard of business transactions where those transactions were entered into for business reasons not related to tax considerations, so they do not support The Tax Court's conclusion that the sale to Capital Company was a sham and not *bona fide.*

In the *Gregory* case, Evelyn Gregory, the petitioner, owned all of the stock of United Mortgage Corp. which held among its assets 1,000 shares of the Monitor Securities Corp. The petitioner planned to distribute these shares to herself in such a manner that the declaration of a dividend, which would be taxable as ordinary income, would be avoided. The Averill Corporation was formed to acquire the 1,000 shares of Monitor held by United Mortgage for which all the stock of Averill was issued to the petitioner, in compliance with Section 112(g)(1)(D), a reorganization section allowing tax exemption for such transactions. Three days later, Averill Corporation was liquidated. Its assets consisting of 1,000 shares of Monitor were distributed in cancellation of its outstanding stock, and the petitioner reported a capital gain on the exchange.

The Board of Tax Appeals decided that the Averill Corp. must be recognized and the reorganization

exemption allowed and consequently the receipt by Evelyn Gregory of the Monitor stock was taxable as capital gain and not dividend income. The Circuit Court of Appeals for the Second Circuit disagreed concluding that the only purpose of the reorganization transactions was to dodge the stockholder's income taxes which was not a true business purpose of either or both companies which were parties to the reorganization, that the transactions "so viewed—were a sham", and Congress could not have intended that the tax exemption should apply to reorganizations which had no real business purpose. The U. S. Supreme Court affirmed the Appellate Court, *Gregory vs. Helvering* (1935) 293 U. S. 465, on the general proposition that the intent of Congress in enacting Section 112(g)(1)(D) was not to allow a transfer of assets by one corporation to another under a plan of reorganization which had no relation to the business purpose of either.

The first time the Supreme Court had occasion to refer to the *Gregory* case, was in the case of *Helvering vs. Minnesota Tea Co.* (1935) 296 U. S. 378, which involved the question of whether a transfer of assets by one company to two separate companies constituted a reorganization, and in holding that it did, the Court stated, in referring to the *Gregory* case:

> "*Gregory vs. Helvering* * * * revealed a sham; a mere device intended to obscure the character of the transaction. We, of course, disregarded the mask and dealt with realities. The present record discloses no such situation; nothing suggests other than a bona fide business move."

When the *Minnesota Tea Company* case came back to the Court (1938—302 U. S. 609), to determine whether certain cash received by Minnesota Tea Company in the reorganization transaction and paid by it to its stockholders under a specific agreement that they would use it to pay the Company's debts, constituted a "distribution" exempting it from tax in the hands of the Company, the Supreme Court explained the applicable statutory provision and the problem in the case as follows:

> "These provisions plainly establish that, in respect of any cash received and not 'distributed', there was a taxable gain to petitioner. And, quite as plainly, payment of the debts by petitioner, if made directly by petitioner to the creditors, would not have been a distribution under the statute; for that contemplates a distribution to stockholders, and not payment to creditors. If, then, petitioner had followed the simple course of retaining in its own hands the sum here in question, and subsequently paying it directly to the creditors, it necessarily would result that liability of petitioner for a tax on the amount of gain could not be avoided. And, obviously, this is the effect of what was done, although circuitously."

The Court concluded:

> "Payment of indebtedness, and not distribution of dividends, was, from the beginning, the aim of the understanding with the stockholders and was the end accomplished by carrying that understanding into effect. A given result at the end of a straight path is not made a different re-

> sult because reached by following a devious path. The preliminary distribution to the stockholders was a meaningless and unnecessary incident in the transmission of the fund to the creditors, all along intended to come into their hands, so transparently artificial that further discussion would be a needless waste of time. The relation of the stockholders to the matter was that of a mere conduit. The controlling principle will be found in *Gregory v. Helvering,* 293 U. S. 465, 469, 470, 55 S.Ct. 266, 267, 79 L.Ed. 596, 97 A.L.R. 1355; and applying that principle here, the judgment of the Court below is confirmed."

In the case of *John Kelley Co. vs. Commissioner,* (1946) 326 U. S. 521, involving the question of whether payments on certain notes or securities constituted dividends or deductible interest, the Court had this to say about the *Gregory* case:

> "There is not present in either situation the wholly useless temporary compliance with statutory literalness which this Court condemned as futile, as a matter of law, in *Gregory vs. Helvering.* * * *"

It seems quite clear that *Gregory vs. Helvering* is intended to apply only in those situations where a "meaningless and unnecessary" transaction was entered into to effect a "temporary compliance with statutory literalness" for the sole purpose of obtaining a tax advantage, in which event the transaction is to be ignored as a sham. As will hereinafter be demonstrated, the transaction involved in the instant case before this Court does not come within the above described category.

In *Higgins vs. Smith* (1940) 308 U. S. 473, a corporation which was wholly owned by the taxpayer litigant, was engaged in a business restricted largely to operations in buying and selling securities from and to the taxpayer, and the purpose of the corporation and these transactions was to gain advantages of income and estate tax savings for the taxpayer, its stockholder. The question involved was the deductibility of a loss on some of these sales transactions from the taxpayer to the corporation. The District Court had instructed the jury to determine whether the sales were actual sales "out of Mr. Smith and into something that existed separate and apart from him" or whether they were to be regarded as simply a "transfer by Mr. Smith's left hand, being his individual hand, into his right hand, being his corporate hand, so that in truth and fact there was no transfer at all." The jury agreed that the latter situation existed. The Circuit Court of Appeals (2nd Circuit) reversed on the ground that the transfers were identifiable events establishing loss. The Supreme Court reversed the Appellate Court, and in its opinion used some very general language about the non-deductibility or non-recognition of a loss in sales of property between a sole stockholder and his wholly-owned corporation because of the retention of control over the property. The Court said:

> "Indeed this domination and control is so obvious in a wholly owned corporation as to require a peremptory instruction that no loss in the statutory sense could occur upon a sale by a taxpayer to such an entity."

This statement has not been applied literally so it must be construed in the light of the particular circumstances of the case and other language used by the Court in its opinion. For example, in commenting upon the fact that Congress had enacted Section 24 (a)(6) of the Revenue Act of 1934, explicitly forbidding losses in transactions between an individual stockholder and his controlled company and answering the argument that in view of that enactment the law was formerly otherwise, the Court stated:

> "At most it is evidence that a later Congress construed the 1932 Act to recognize separable taxable identities between the taxpayer and his wholly owned corporation. As the new provision goes much farther than the former decisions in disregarding transfers between members of the family, it may well have been passed to extend as well as clarify the existing rule. The suggestion is not sufficiently persuasive to give validity to a futile transfer."

(The Section 24(a)(6) of the Revenue Act of 1934 above referred to is still in the law as Section 24(b) of the Internal Revenue Code, *and it is significant that the Section does not forbid the deduction of losses in transactions between a corporation and its controlled subsidiary.* It applies only to losses in sales between an *individual* and his controlled corporation. It would not be applicable to a sale from the Bank to Merchants.)

It is difficult to avoid the conclusion from a reading of the case that the decision was induced by the fact

that the sales were made for the sole purpose of avoiding tax liability. For example, the Court stated:

> "The Government may look at actualities and upon determination that the form employed for doing business or carrying out the challenged tax event is unreal or a sham may sustain or disregard the effect of the fiction as best serves the purpose of the tax statute. To hold otherwise would permit the schemes of taxpayers to supersede legislation in the determination of the time and manner of taxation. It is the command of income and its benefits which marks the real owner of property."

This Court—Court of Appeals for the Ninth Circuit, in its decision in the case of *Laughton vs. Commissioner* (1940) 113 F(2d) 103, recognized that the Supreme Court's opinion in the *Higgins vs. Smith* case was so composed that it is impossible to interpret any single expression in the opinion without reference to the whole context. In the *Laughton* case, Mr. Laughton, an actor, was employed under contract by a British Corporation, all of whose stock he owned. This Company "loaned" him to American producers at a compensation in excess of what the corporation paid him and the Government attempted to ignore the corporate entity and tax the entire compensation to Mr. Laughton. This appellate Court sustained the Board of Tax Appeals in holding that the corporate entity could not be ignored. After a careful analysis of the Supreme Court's decision in *Higgins vs. Smith,* the Court concluded:

> "It is arguable that the Higgins decision means that no matter what the particular 'tax event'

may be, if it be more profitable to the tax collector to disregard the intervening corporate entity this must be done. However, it seems to us that if this were the intent of the court it would have said so and not spread its consideration of the cases over many pages of the opinion with such qualifying language as is quoted above.

We take the opinion to mean that the 'tax event' is not an unreal attempt to use a corporation for a sham transaction, procuring an advantageous tax consequence to the taxpayer, if it may be considered as one primarily for an independent business purpose and not a transfer of assets (here Laughton's services), with a retention of their control, solely to reduce tax liability."

And in the case of *Samson Tire & Rubber Co. vs. Riegan* (1943) 136 F(2d) 345, 347, this Court stated:

"It is true that, for tax purposes, a transaction which is unreal or sham may be disregarded. *Higgins vs. Smith.* But a real transaction, having an independent business purpose, may not be disregarded, though designed to procure 'an advantageous tax consequence' ". *Com. vs. Laughton,* supra (113 F(2d) 104).

This Court's interpretation of the *Higgins vs. Smith* case has support in the reference which the Supreme Court made to its *Higgins vs. Smith* decision the first time it referred to it, which was in the case of *Moline Properties, Inc.,* 319 U. S. 439.

In *Moline Properties Inc. vs. Commissioner,* (1943) 319 U. S. 439, there was a question as to whether certain profits made by the Corporation with a limited

business, should be taxed to the corporation as claimed by the Government, or to the sole stockholder. After emphasizing the rule that the corporate identity should not be ignored or disregarded, the Court stated:

> "In general, in matters relating to the revenue, the corporate form may be disregarded where it is a sham or unreal. In such situations the form is a bald and mischievous fiction. *Higgins vs. Smith* * * *, *Gregory vs. Helvering* * * *".

The Court held the income properly taxed against the Corporation.

There are a great many cases in which *Gregory vs. Helvering* and *Higgins vs. Smith* have been followed or distinguished. In every case in which the decisions have been followed there existed the element of tax avoidance as the inducement for the questioned transaction. *We have not been able to find a single case in which a transaction entered into for a purpose entirely foreign to tax considerations was ignored.*

In *Commissioner vs. Capento Securities Co.,* (C.C.A.-1-1944) 140 F(2d) 382, the Court held that *Gregory vs. Helvering* was not applicable, concluding, "in the case at bar the reorganization was not resorted to in order to evade an impending tax liability." In *Electrical Securities Corp. vs. Commissioner,* (C.C.A.-2-1937), 92 F(2d) 593, Judge L. Hand indicated that it was his view of *Gregory vs. Helvering,* that a transaction was a "sham" if its only purpose was to avoid a tax and the medium used to achieve such a result had no other business purpose. In *Richard H. Survaunt,* 5 T.C. 665, Aff'd. C.C.A.-8-1947, 162 F(2d)

753, a reorganization was not disturbed even though the stockholders had a personal—as opposed to a corporate—reason for the arrangement. Similarly, a reorganization for the convenience of stockholders was upheld in *Souther,* (1939) 39 B.T.A. 197, 214-216. In *Commissioner vs. Kolb,* (1938) 100 F(2d) 920, this Court found that reasons, both for the convenience of the corporation and of the preferred and common stockholders, were sufficient to uphold the reorganization. These are some examples of situations in which the Courts have refused to disregard transactions which were not entered into solely for tax considerations.

The foregoing analysis of the authorities shows conclusively that The Tax Court was wrong in this case in concluding that the doctrine of the *Gregory vs. Helvering* and *Higgins vs. Smith* cases requires a disregard of the sales of property by the Bank to Capital Company and the sales by Capital Company to Merchants. The transactions were consummated legally and effectively, they were made for a definite purpose not related to taxes, and they were not made to avoid tax liability. Under these circumstances the *Gregory vs. Helvering* and the *Higgins vs. Smith* cases cannot apply. Since these decisions and the principles applied therein do not apply, the sales to Capital Company must be regarded and accepted as *bona fide,* and they cannot be classified as mere sham.

The establishment of the sales as *bona fide* eliminates one of the grounds on which The Tax Court based its refusal to recognize the sales, but it does

not necessarily require the allowance of a loss resulting therefrom. If the sales were not closed and completed transactions, which is another ground on which The Tax Court based its refusal to recognize the sale, no loss can be recognized. The question of whether these sales qualify as closed and completed transactions is something different from the question of whether the sales were *bona fide* and real. This question will now be answered to show that the sales were closed and completed transactions, and qualify as transactions from which gain or loss must be recognized for tax purposes.

(d) The Sales to Capital Company Were Closed and Completed Transactions and Gain or Loss Realized Therefrom Must Be Recognized for Tax Purposes. The Tax Court Was Wrong in Concluding That They Could Not Be Recognized as Closed Transactions and That Capital Company Was a Mere Conduit for a Transfer of the Property to Merchants.

The Tax Court concluded that Capital Company "was merely a conduit for the passage of title to the eight bank properties from petitioner to Merchants". (R. 138.) The Court also stated that, "Capital was obligated to deliver deeds to the eight branch banks back to petitioner or Merchants, and the parties never intended, under any circumstances, that Capital should retain title to any of the eight properties." (R. 138.) This conclusion, if it is intended to be taken literally as it would have to be interpreted if it is to be sufficient to sustain the Court's decision that the sale to Capital Company must be disregarded, is contrary to the facts as stipulated. Again, a careful analysis of the facts is important.

Enough has already been said about the facts to establish that the sales from the Bank to Capital Company were made to settle the controversy with the Comptroller of the Currency in a manner consistent with the position which the Bank had maintained throughout the controversy. The Bank's position was that it had the right to carry its banking premises on its books at cost less ordinary depreciation and that the Comptroller had no authority to require a write-down. (Stip. Paragraph 4, R. 34.) When the proffered settlement required a charge-off how could the Bank effect the charge-off without making it a straight write-down and thus being put into a position of having established a precedent for possible similar action on the part of the Comptroller in the future? That was the question which the Bank officers asked of their counsel. (Ex. 14-N, R. 91.) The counsel's memorandum reflects quite clearly, the line of thinking on the part of the Bank officials during the conference with the Bank's counsel. The memorandum shows that in response to their question he "advised them that they could probably arrange to purchase and sell properties between the Bank and Merchants National Realty Corporation, so that the purchase price of the respective properties would be a figure satisfactory to the Committee and in accordance with the agreement." (Ex. 14-N, R. 82.) The response to this answer is very significant since it shows that the Bank officials were of the opinion that such a transaction did not result in a sufficient divesting of control of the properties by the Bank to sup-

port a claim that a real sale had been made and a new cost established. The memorandum explains this response as follows:

> "The Bank officers felt that since it was a transaction between the parent and a wholly owned affiliate, the purchase and sales transaction might be ignored and the transaction considered a write-down which would establish a precedent whereby the Bank might be compelled to continue the practice of arbitrarily writing down its banking premises. The Bank, of course, did not wish to establish a precedent or to be in a position where it could ever be faced with the contention that it had previously recognized the legality of any requirement by the Comptroller of the Currency that banking premises should be arbitrarily written down." (Ex. 14-N, R. 92.)

The objection of the Bank's officers led to an obvious suggestion—sell to some outside interest! So, the Counsel's memorandum continues:

> "I then suggested that if the Bank and Merchants National Realty Corporation should be willing to assume the risks which might result where property is removed from their hands even for a short period of time, they might arrange with some other company, such as Capital Company, to purchase the property from one and then sell to the other." (Ex. 14-N, R. 92.)

The Bank officers agreed to follow this program and asked the Bank's Counsel, "that I should instruct them as to the method of carrying out these transactions for the purposes indicated * * *." (Ex. 14-N, R. 94.)

There can be no doubt that the Bank wanted to make a sale of property in such manner that it would be completely divested of ownership and control for a period of time. It was only through such a transaction that the Bank could make a charge-off of a loss as a loss from sale rather than as a straight write-down of book costs.

After this conference with the Bank's Counsel, an officer of the Bank entered into negotiations with the President of Capital Company. The Bank's position was fully explained and an agreement was reached as explained in paragraph 5(c) of the Stipulation (R. 35-36), in effect as follows:

(1) That the Bank or Merchants would sell particular properties to Capital Company for cash for a price equal to the appraised value of the respective properties.

(2) "That the Bank intended to and would" repurchase, the properties within thirty days or so after their sale to Capital Company, and "Capital Company agreed" to resell the properties to the Bank or Merchants for cash for the same amount it had paid for the properties plus acquisition costs, "at any time upon request of the Bank."

(3) "That there would not be any written agreement between the Bank, Merchants and Capital Company," concerning the resale of the property.

(4) That while Capital Company owned the property, "the Bank would pay to Capital Company as rental amounts equal to 6% per annum net upon the

amounts paid by Capital Company" for the properties.

It was stipulated that the transactions "were effected pursuant to and in accordance with this agreement," (R. 36) and it was further stipulated in paragraph 6 of the stipulation (R. 37), "in carrying out the aforesaid transactions, all formalities in connection therewith, such as the execution and recording of deeds, the affixing of documentary stamp taxes, the transfer of fire insurance, and the recording of the transactions on the books of all companies as purchases and sales of property were complied with. When the properties were deeded to Capital Company, the outstanding fire insurance policies covering the respective properties were amended by rider to provide that any loss payable thereunder should be paid to Capital Company; and when Capital Company deeded the properties to the Bank or to Merchants the policies were again amended by rider to provide that any loss payable thereunder should be paid to the Bank or to Merchants respectively." Upon the sale to Capital Company, "the Bank and Capital Company executed" a comprehensive lease agreement (Ex. 10-J, R. 81) "with respect to each property, and the rentals received under said lease agreements were reported by Capital Company as rental income on its income tax return, and by the Bank as rental expense on its tax return." (R. 38.)

The transfer of property for a monetary consideration is a sale. The above statement of facts taken from the stipulation leaves no room for any other con-

struction than that the Bank sold properties to Capital Company, transferring all title and control to Capital Company for a cash consideration amounting to $2,-853,000. (Ex. 8-H, R. 79.) This is not a case of a "temporary compliance with statutory literalness" for the purpose of obtaining a tax advantage, condemned by *Gregory vs. Helvering* (*John Kelley Co., Supra,* 326 U. S. 521). It is a case of a careful, deliberate and literal compliance with statutory requirements involving a sale of property from a seller to a buyer, to protect the buyer from any defect in the transaction which might jeopardize an investment of over $2,800,000 in the property. This was a real transaction, not a sham.

The agreement between the Bank and Capital Company *not* to reduce to writing the understanding as to the resale of the property, was deliberate and not without purpose. As hereinbefore pointed out in the discussion of the Counsel's memorandum (Ex. 14-N, R. 91), supra, p. 23, the Bank officials were cognizant of the fact that to do what they wanted to do, to have the effect they wanted it to have, they would have to negotiate a sale which could have no legal detriment, a sale which would completely and effectively divest the Bank of title and control of the property, and it is stipulated that this was explained to Mr. Woodruff, President of Capital Company when the sales were negotiated. Although the Bank represented that it intended to and would repurchase the property and Capital Company agreed that it would resell at any time the Bank offered to repurchase, both

parties *deliberately agreed not to reduce this to writing which is a specific agreement that the repurchase agreement was not to have legal effect.*[1]

This was not a "meaningless and unnecessary incident" of the transaction of the type condemned in the *Minnesota Tea Company* case, *Supra* (302 U.S.

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[1]Sections 1971 and 1973 of the California Code of Civil Procedure:

"*1971. Transfer of real property to be in writing.* No estate or interest in real property, other than for leases for a term not exceeding one year, nor any trust or power over or concerning it, or in any manner relating thereto can be created, granted, assigned, surrendered, or declared, otherwise than by operation of law, or a conveyance or other instrument in writing, subscribed by the party creating, granting, assigning, surrendering, or declaring the same, or by its lawful agent thereunto authorized by writing.

1973. (What agreements must be in writing.) In the following cases the agreement is invalid, unless the same or some note or memorandum thereof be in writing, and subscribed by the party charged, or by his agent. Evidence, therefore, of the agreement, cannot be received without the writing or secondary evidence of its contents:

1. An agreement that by its terms is not to be performed within a year from the making thereof;

2. A special promise to answer for the debt, default, or miscarriage of another, except in the cases provided for in section 2794 of the Civil Code;

3. An agreement made upon consideration of marriage other than a mutual promise to marry;

4. An agreement for the leasing for a longer period than one year, or for the sale of real property, or of an interest therein; and such agreement, if made by an agent of the party sought to be charged is invalid, unless the authority of the agent is in writing, subscribed by the party sought to be charged;

5. An agreement authorizing or employing an agent or broker to purchase or sell real estate for compensation or a commission;

6. An agreement which by its terms is not to be performed during the lifetime of the promisor, or an agreement to devise or bequeath any property, or to make any provision for any person by will;

7. An agreement by a purchaser of real property to pay an indebtedness secured by a mortgage or deed of trust upon the property purchased, unless assumption of said indebtedness by the purchaser is specifically provided for in the conveyance of such property."

609). It was a necessary incident to accomplish what both parties intended, namely, that the sale from the Bank to Capital Company was to be a completed transaction effecting a transfer of complete title, control and domination of the property from the Bank to Capital Company. It was only by such a transaction that the Bank could accomplish its objective with respect to the settlement of the controversy with the Comptroller, and Capital Company was aware of that fact.

It was because the parties were so very careful to accomplish such a transfer, that Capital Company had to be so careful that its position as owner of the property with an investment therein of over $2,800,000 was protected during the period it owned the property. During this period it had all the benefits, burdens and risks of ownership of the property. Had there been a disaster during this period, any loss not covered by insurance would have fallen upon Capital Company. It received the rental income from the property and reported it as such on its income tax returns. *The Government has not questioned these rentals so to that extent at least it has recognized that Capital Company had control and ownership of the property while it had title to the property.*

This Court stated in the case of *Rasmussen vs. Eddy's Steam Bakery* (1932) 57 F (2d) 27 (cert. denied), "The question of title and income are inextricably interwoven. It characterizes the possession of the property and determines the ownership of the income thereof." Under this principle the taxing of

the income to Capital Company characterizes it as the owner of the property. The recognition of Capital Company as the owner of the property must necessarily require recognition of the transaction by which it became the owner.

The above recital of the facts shows conclusively that there is no factual support whatever for the conclusion that Capital Company was, and was intended to be, a mere conduit for transmittal of the property from Bank to Merchants, or for the further conclusion that the Bank did not transfer, and never intended to transfer, complete title, dominion and control of the property to Capital Company. The facts establish that the parties intended that the sale should be a closed and completed transaction; they intended that the Bank should be divested of all title, dominion and control of the property immediately upon the sale to Capital Company; they intended that Capital Company should have exclusive title, dominion and control and all benefits and burdens of ownership while it was the owner of the property and until such time as it might resell the property to the Bank; and the actual mode of transfer and the formalities which were followed, carried out the intentions of the parties.

The Tax Court seemed to think that the repurchase arrangement, with the subsequent repurchase, justified a conclusion that the sale to Capital Company could be considered merely a step in the consummation of a single transaction—a transfer to Merchants —and on the principle that the separate steps of an

integral transaction must be construed taxwise by the results accomplished upon the consummation of the entire transaction, the sale to Capital Company could be disregarded. As will immediately hereinafter be shown *this principle never applies where the parties intended the separate steps as separate and distinct transactions, unless the real intent and the sole purpose of the transaction was tax avoidance.*

(e) The Sales to Capital Company and From Capital Company to Merchants Were Separate and Distinct Transactions and in the Absence of Any Intention to Avoid Tax, They Cannot Be Treated as a Single Transaction Involving a Sale From the Bank to Merchants, and the Sale to Capital Company Cannot Be Disregarded.

The mere fact that Merchants purchased the properties after Capital Company had owned them for 30 days or so cannot vitiate the original sale. Prior to the enactment of Sections 23 (j) and 118 of the Internal Revenue Code taxpayers could almost simultaneously sell and repurchase securities and deduct the loss resulting from the sale. (*Pennsylvania Co. for Insurance vs. Commissioner* (1925) 2 BTA 48.) Although Sections 23 (j) and 118 provide for the disallowance of the loss from such a sale they do not relieve the taxpayer from tax on any gain resulting from such a sale. Furthermore, the Sections apply only to wash sales occurring within a thirty-day period. If a taxpayer sells stock at a loss with a deliberate intent of repurchasing the stock on the 31st day after the sale regardless of price, he may deduct the loss.

There is nothing in the statutes which requires a taxpayer to hold *real estate* any particular length of time as a condition to the deductibility of any loss from the sale of the property (excepting as recognition of loss is affected by the capital gains and losses sections not involved in this proceeding).

In the case of *U. S. vs. Cumberland Public Service Company* (1950) 70 Sup. Ct. 280, shareholders of a corporation sold property immediately after receiving it as a liquidating dividend for the specific purpose of selling it, and the Supreme Court refused to disregard the transaction as a sale by the shareholders, and the Court refused to construe the transaction as a sale by the Corporation which had made the distribution, and therefore refused to apply the principle that the separate steps could be ignored and the transaction considered as a sale by the Corporation and a distribution of the proceeds to the stockholders as a liquidating distribution. There is an accepted doctrine that where several steps must be taken to accomplish a certain objective and the separate steps are not intended to be independent but are intended only as a means for accomplishing the objective, the separate steps may be ignored and the transaction may be viewed as a single transaction from the position of the taxpayer at the start to the position of the taxpayer after the accomplishment of the objective. This doctrine seems to be limited quite generally to reorganization transactions where several steps are usually necessary to complete the reorganization. It is also applied, however, to cases

where a single step is deliberately separated to avoid a tax. It is never applied to permit a closed transaction to be ignored merely because it is followed by another completed transaction involving the same subject matter, regardless of how closely the one might follow the other in formality or point of time. We have been unable to find a single case where separate transactions were treated as one where the parties intended the transactions to be separate and where the purpose of the transactions did not involve tax avoidance.

In the case of *J. D. Bigger* (1930) 19 BTA 797, a taxpayer contributed $1200 to a syndicate under a plan whereby the syndicate was to acquire certain oil leases and transfer them to an operating corporation for stock. This was accomplished within a period of a few months. The Court described the issue—"If the Board considers this transaction as a continuing one and in effect a purchase by the petitioner of shares of stock in the Emerald Petroleum Co. through the medium of the syndicate to which cash was advanced prior to the organization of the corporation, but in pursuance to the general plan of its formation, then the petitioner realized no profit. If, on the other hand, the Board agrees with the contention of the Commissioner that the purchase by the petitioner of an interest in the syndicate constituted a closed transaction from which profit was realized when an exchange of such interest for stock was effected and that said stock had a market value of $20 per share, the taxpayer realized a profit of $2,480."

In its opinion, the Board of Tax Appeals analyzed the applicable legal principle as follows:

> "So-called continuing transactions, involving separate and distinguishable steps in a general plan, have been considered by us in cases resulting from the merging or reorganizing of corporation. In the case of *William H. Mullins,* 14 B.T.A. 426, we said:
>
> > * * * The fact that these several transactions together comprised a single plan of reorganization does not render them any the less separate and distinct undertakings. The nature of each transaction is determinable from the facts relating to it, and is not changed because of its association with other transactions in a larger and more comprehensive plan.'
>
> The petitioner's contribution of $1,200 to the syndicate, by which he acquired a direct interest in the oil leases, was a distinct step in the general plan, and, even though in contemplation of the ultimate receipt of shares of stock in the operating company, constituted a closed transaction at least for tax purposes. *Edward A. Langenbach,* 2 B.T.A. 777; *B. F. Saul,* 4 B.T.A. 639; *William H. Mullins, supra,* cf. *A. J. Siegel,* 4 B.T.A. 186; affd., 25 Fed. (2d) 1022; *J. A. Staley,* 9 B.T.A. 932; *T. B. Noble,* 12 B.T.A. 1419; affd., 5th Cir., C.C.A., Oct. 21, 1929. * * *
>
> We accordingly hold that the purchase by the petitioner of an interest in the syndicate and the subsequent exchange of that interest for shares of stock in the corporation resulted in taxable gain as found by the respondent. *E. C. Huffman,* 1 B.T.A. 52; *V. J. Bulleit,* 3 B.T.A. 631; *Napoleon*

B. Burge, 4 B.T.A. 732; *Douglas F. Fesler,* 13 B.T.A. 1356; 38 Fed. (2d) 155; *R. V. Board,* 14 B.T.A. 374; *Edward H. Mount,* 16 B.T.A. 847; *Cullinan v. Walker,* 262 U. S. 134."

In *Chandler Shipbuilding Co. vs. Commissioner,* (1931) 22 B.T.A. 5, a partnership wanted to exchange assets for stock of a newly organized corporation, but in order to meet the requirements of the Corporation Commissioner the partnership bought the stock for cash and the corporation immediately used the cash to buy the assets. In holding that the transaction was not an exchange of assets for stock but was a purchase of stock for cash entitling the company to use the amount paid as part of its invested capital, the Board stated:

> "It was the incorporator's direct purpose not to exchange shares for assets, because such a method would have required several months for an official valuation, and it was this delay which petitioner sought to and did avoid * * * *Under such circumstances it cannot be held that the method of organization chosen involved vain steps to which substantive effect should now be denied, when such method was deliberately and openly adopted for substantial reasons at the time."* (Italics ours.)

In commenting upon this case later the Board said:

> "It is only in those instances where the evidence warrants the conclusion that the steps taken or acts done were never intended to be of substantive effect that disregard of form is justified. *Ralph F. Chandler Shipbuilding Co.,* 22 B.T.A.

5." (*Bancitaly Corporation* (1936) 34 B.T.A. 494, 506.)

This Court gave approval to this principle in the case of *First Seattle Dexter Horton National Bank vs. Commissioner* (1935) 77 F. (2d) 25; Cf. *U. S. vs. Santa Inez Co.* (1945) 145 F. (2d) 667.

The facts as stipulated show conclusively that the sales to Capital Company were intended to be of substantive effect—the very purpose and objective of the Bank required that the transaction be of substantive effect and accomplish a complete divestment of title and control of the properties sold, and the facts show that the sales were not made to avoid a tax, so the sales must be recognized as independent transactions from which gain or loss is determinable under applicable provisions of the income tax statutes, and the sales cannot be ignored as a mere medium for conveyance of the property to Merchants.

In *American Bantam Car Co.* (1948), 11 T. C. 397, Aff'd. C.C.A.-3-1949, 177 F. (2d) 513, three individuals transferred assets to a corporation in June 1936, at the same time agreeing with stock underwriters that upon their distribution of preferred stock of the new company they would receive a certain part of the common stock issued to the three individuals. When the common stock was first issued the three individuals had control so Section 112(b)(5) would be applicable and the basis of the property to the corporation would be the same as the basis in the hands of the transferor. (Section 113(a)(8).) After the preferred

stock was issued and the underwriters received some of the common stock, the three individuals did not have "control." The Tax Court explained the taxpayer's position as follows:

> "Petitioner, however, contends that the series of steps organizing the new corporation, transferring assets to it, and arranging for the sale of its preference stock must be considered as parts of the integrated plan formulated in May 1936, and, therefore, considered as parts of a single transaction. It argues that this unified transaction started on June 2, 1936, when petitioner was incorporated, and ended in October 1937, when the public offering of the preferred stock by the underwriters ceased and Grant was awarded 87,900 shares of common stock; that the transfer of common stock to Grant in 1937 was the final step in an indivisible operation and must be viewed concurrently with the preceding steps. On this theory the associates did not obtain control of petitioner, for on consummation of this final step in the general plan the associates had only 212,100 shares of common stock, while Grant had 86,900 shares and the public had 1,008 and there were 83,618 shares of outstanding preferred stock owned by the public. The 212,100 stock votes held by the associates in October 1937 fell shy of the required 80 per cent to give the requisite control."

The Tax Court then gave a very interesting explanation of its view as to the test to be applied in determining whether a series of transactions should be considered a single transaction for tax purposes. It said:

"In determining whether a series of steps are to be treated as a single indivisible transaction or should retain their separate entity, the courts use a variety of tests. Paul, Select Studios in Federal Taxation, 2d series, pp. 200-254. Among the factors considered are the intent of the parties, the time element, and the pragmatic test of the ultimate result. An important test is that of mutual interdependence. Were the steps so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series?"

In applying the test the Court stated:

"The standard required by the courts to enable them to say that a series of steps are interdependent and thus should be viewed as a single transaction do not exist here. It is true that all the steps may have been contemplated under the same general plan of May 1936; yet the contemplated arrangement for the sale of preferred stock to the public was entirely secondary and supplemental to the principal goal of the plan—to organize the new corporation and exchange its stock for the Austin assets. The understanding with the underwriters for disposing of the preferred stock, however important, was not a *sine qua non* in the general plan, without which no other step would have been taken."

The Court then concluded that the transfer of assets for stock was an independent transaction and subject to whatever tax effect would have to be given it under the Statute, that it came within Section

112(b)(5) and therefore the basis of the assets was the transferor's basis under Section 113(a)(8).

The test prescribed by The Tax Court is simple and clear cut. If applied to the case now under consideration there could be no doubt that the sale to Capital Company would have to be considered independent of the "informal" option to the Bank to repurchase, and independently of the later sale from Capital Company to Merchants. Paraphrasing the language of The Tax Court in the *American Bantam Car Co.* case, "The understanding with" Capital Company for resale of the properties, "however important, was not a *sina qua non* in the general plan, without which no other step would have been taken."

The record in this case establishes that the primary purpose was to make a binding unconditional sale of the property to Capital Company to accomplish a certain objective unrelated to taxes. The understanding about the resale of the property by Capital Company was purposely legally unenforceable; the Bank could have decided not to repurchase the property, and Capital Company could have sold to someone else, and in either case the validity of the original sale to Capital Company would not have been affected. The object of the original sale was to accomplish a result which could be accomplished only by that sale. The later sale to Merchants was "entirely secondary and supplemental to the principal goal of the plan", and could contribute nothing to the accomplishment of that goal, so it could not be treated as a transaction so interdependent or indivisible with the original

transaction as to warrant a disregard of the original sale as a separate transaction. Applying The Tax Court test, were the steps so interdependent that the legal relations created by the original sale to Capital Company would have been quite fruitless without the resale to the Bank or Merchants? Absolutely not! Actually, The Tax Court determination of the transaction as a single transaction involving a sale from the Bank to Merchants is in direct conflict with the recognized test, because if the transaction were one, as so construed, it would have been "fruitless" and useless for the accomplishment of the only purpose for which the transaction was effected—the establishment of a loss on the sale to Capital Company, to meet the requirements of the Comptroller. The transaction as construed by The Tax Court has no relationship to the business purpose which prompted the real transaction. It is like calling a cat a dog! The Bank made a sale to Capital Company for a particular business purpose. The Tax Court says the Bank did not sell to Capital Company but sold to Merchants. Why would it sell to Merchants? *The record shows that it was especially conscious that it could not fulfill its business purpose by selling to Merchants so it deliberately sold to Capital Company instead.* (Ex. 14N, R. 91) Just as the Court concluded in the *American Bantam Car* case that to ignore the issuance of the 300,000 shares of stock to the three individuals would require an unsupportable conclusion that title to those shares was suspended until the underwriters received part of them, so also it might be said in this case that to ignore the sale to Capital Company requires an

unsupportable conclusion that title to the property was suspended until the Bank should repurchase the property. The stipulation shows that Capital Company acquired and held title and ownership of the property and realized income therefrom which it reported as rental income on its tax return.

It is one thing to construe separate steps as a single transaction where the objective of the transaction is to go from the first to the last step to accomplish a desired business purpose; but it is something else again to ignore the very transaction consummated to effect the desired business purpose and to construe the transaction as one entirely different from what the parties intended and which really has no point or purpose, and one which the parties never would have entered into and deliberately refrained from entering into. Neither the test set forth in the *American Bantam Car* case nor any other rule of construction or of law justifies such a conclusion.

So far, it has been established that the sale to Capital Company was a bona fide sale. It was made for a purpose unrelated to tax avoidance and effectively divested the Bank of all title and control over the property sold. It was deliberately intended that such divestment of title and control should continue at least for a period of time. It has been established that under these circumstances the sale must be recognized for tax purposes, separate and apart from the later sale by Capital Company to Merchants. The only point remaining of those which The Tax Court discussed in its refusal to recognize the sale, is whether

the understanding regarding the possible repurchase of the property by the Bank or Merchants is sufficient to warrant the conclusion that the sale to Capital Company was not a closed and completed transaction.

(f) The Sales to Capital Company Were Closed and Completed Transactions and the Tax Consequences of These Sales Could Not Be Affected by the Later Sale of the Properties by Capital Company to Merchants. The Tax Court was Wrong in Concluding That the Understanding About the Resale of the Property by Capital Company Vitiated the Sales to Capital Company and Justified a Disregard of These Sales for Tax Purposes.

The Tax Court in concluding that the sale could not be recognized as a closed and completed transaction, relied upon *Shoenberg vs. Commissioner,* 77 F (2d) 446 and similar cases.

In *Sydney Shoenberg vs. Commissioner* (CCA-8-1935), 77 F (2d) 446, cert. denied, affg. 30 B.T.A. 659, the taxpayer gave instructions to a broker to sell certain personally owned stocks and at the same time instructed the broker to buy identical quantities of the same stocks on behalf of a corporation of which petitioner was president and in complete control. At the expiration of 30 days the corporation transferred the stocks to petitioner in his personal capacity. The basic premise of the transaction was to avoid taxes. On the evidence the Board concluded that the corporation was for all practical purposes an alter ego of the taxpayer, being entirely dominated by him; and since the whole transaction showed *a persistent intention* by the taxpayer to hold title and dominion over the stocks it did not amount to a bona fide sale, citing

Sharp vs. Commissioner, 38 B.T.A. 166, 174. The Appellate Court explained a philosophy of taxation which requires that a loss to be allowable as a deduction, must be a real loss sustained in a closed transaction and a loss from a sale of property is not real if the sale is made part of a plan whereby the same property or substantially identical property is to be reacquired and that plan is carried out. In this case the Court concluded, "Examining the entire transaction, it is clear that this sale by the taxpayer was merely a part of a plan by which he hoped to create a deductible loss without any real change in his position". Again the spectre of unsympathetic reaction to a transaction having no other purpose than tax avoidance!

In a later decision in the case of *Helvering vs. Johnson* (1939) 104 F (2d) 140, the Court of Appeals, 8th Circuit, which had decided the *Shoenberg* case, allowed a deduction for a loss on a sale by a taxpayer to a corporation which he controlled and 50% of whose stock he owned. In referring to *Commissioner vs. Dyer* (CCA-2-1935) 74 F (2d) 685, *Rand vs. Helvering* (CCA-8-1935) 77 F (2d) 450, and *Shoenberg vs. Commissioner,* Supra, the Court described those cases as involving a situation "where a *pretended* sale of stock is made under a plan which contemplates the reacquisition of the stock sold or its equivalent." The Court pointed out that the vendee company was not organized for tax advantage, so the Court would not construe the sale as a transaction in which the taxpayer retained control of the property through control

of the corporation, and the Court would not disregard the tax effects of the sale.

Where a sale is actually made, and is not merely a "pretended" sale, it must be recognized for tax purposes as a sale even though the purchaser might have purchased the property as an accommodation to the seller.

In *J. Harold Frantz,* B.T.A. Memo Docket 82426, Oct. 15, 1938, a corporation "accommodated" the taxpayer by purchasing certain land from him although the corporation did intend to use the land for a business purpose. At the time of the purchase, the corporation agreed verbally with the taxpayer that he could repurchase the land at the same price, if it remained unsold. A few months after this transaction, the taxpayer reacquired the property. The Board held that the loss on the sale was allowable, and that the verbal agreement for repurchase was an option which did not prevent the sale from being a closed transaction from which a deductible loss was sustained, citing *Helvering vs. San Joaquin Fruit & Investment Co.,* 297 U. S. 496.

In the case of *Bancitaly Corp.* (1936) 34 B.T.A. 494, 513 to 516, the taxpayer was acquiring a bank in New York and the Comptroller of the Currency refused to give the Bank a permit to establish a trust department unless the taxpayer holding company disposed of all of the stock of the Bank within six months. In an effort to comply with this requirement the taxpayer holding company transferred 150,000

shares of the stock to National Bankitaly Co., its securities dealer affiliate which had a sales organization and other facilities for selling the stock to the public. The transfer was effected in the form of a sale of the stock at $225.00 per share with the understanding that the parent company would take back any shares which National Bankitaly Co. could not sell. In a few months the market weakened and the stock dropped in value to $195.00 per share, whereupon Bancitaly Corp. took back the unsold balance of 84,198 shares giving credit of $225.00 per share therefor to National Bankitaly Co. and Bancitaly Corp. thereafter distributed the remaining stock to its stockholders as a dividend distribution. The Government and the Board of Tax Appeals held that the transfer of the 150,000 shares involving a profit of some $18,000,000 was one completed transaction so the entire profit was taxable, and the second transaction was a purchase of stock and a separate and distinct transaction, notwithstanding the agreement between the affiliated companies for a take-back of the unsold shares. (See dissenting opinion 34 B.T.A. 516.) The majority concluded, "Though there was, in a certain sense, a relationship between the two transactions, it was not such a relation as to make the two transactions one in law or to make the original sale incomplete or conditional. See *Jacob M. Dickinson,* 18 B.T.A. 790; *Daisy M. Ward,* 29 B.T.A. 1251".

Bancitaly Corp. was a predecessor of Transamerica Corp. which prior to 1937 owned all of the stock of the Bank of America, the appellant herein. The Tax

Court in this proceeding distinguishes the *Bancitaly Corp.* case by the terse statement "as the basis for the holding that taxable income was realized, the Board expressly found as a fact that the sale of 150,000 shares of stock and the subsequent repurchase of 84,198 of the shares were two separate and independent transactions and that the original purchaser was under no obligation to resell any of the shares to petitioner. In this proceeding, however, Capital was merely a conduit for the passage of title to the eight bank properties from petitioner to Merchants." (R. 137-138.) In appellant's viewpoint this is a distinction without a difference and if, as we think is established in this brief, the Tax Court has improperly construed the facts in determining that the sale to Capital Company and the sale to Merchants were not separate transactions, there is no difference between the cases.

Naturally the appellant does not relish a rule of construction which does not work both ways. In both the *Bancitaly Corp.* case and this case, transactions were effected to meet requirements of the Comptroller; in both cases there was no tax avoidance inducement or reason for what was done; in the *Bancitaly Corp.* case there was an agreement with an affiliated company to take back unsold stock, whereas in this case there was an understanding with Capital Company (not an affiliated company) that the property would be resold if the Bank wanted to repurchase, but the original sale was deliberately intended to be a closed and completed transaction; in the *Bancitaly Corp.* case there was a very substantial proft which was taxed—actually an unrealized profit in the sense that

the affiliated group ever reduced it to cash realization, in this case there is a loss for which no deduction is being allowed. The instant case presents a so much stronger factual basis than the *Bancitaly Corp.* case for a conclusion that the original sale was a closed and completed transaction, that the *Bancitaly Corp.* case must be acknowledged as an authority supporting the Appellant's position in this case that the agreement about a possible repurchase of the property was not sufficient to avoid the tax consequences of the original sale as a closed and completed transaction for tax purposes. *Certainly if a profit had been realized on the sale to Capital Co. the profit would be recognized and taxable*—the answer should be the same in the case of a loss. There was "retained control" of the stock originally sold by Bancitaly Corp. and yet the Court did not deem such retention of control sufficient to justify a disregard of the sale. If the original transaction is complete and was not made for the purpose of tax avoidance it cannot be ignored. This is the rule—it was followed in the *Bancitaly Corp.* case but it was not followed in this case, and the Tax Court was wrong in not following it.

It is apparent from a study of the cases relating to the deductibility of losses sustained from sales of property, many of which have been analyzed above, that the test of deductibility depends upon the intention of parties to the sale as to whether the sale was to be a real bona fide sale. If the sole purpose of the transaction or series of transactions from which the loss alleged to have been sustained is to create a tax loss and avoid tax, the sale trans-

action or other transactions by which this is accomplished are considered to be merely *pretended sales* or transactions and therefore unrealistic or a sham.

If the tax avoidance scheme is absent, a transaction must necessarily be given its effect according to its form because whatever the purpose might be, the intent must necessarily have been that the transaction in form should be effected to reach the intended objective. Where the tax avoidance scheme is absent, the Courts will recognize intent and purpose as separate and distinct factors and in such instances the purpose will not be applied to vitiate the intent with respect to the transactions employed to reach the desired purpose. There is no case where a sale was made for a purpose other than to accomplish a tax avoidance in which it was held that the sale was to be disregarded, even though there might have been a subsequent transaction no matter how close in point of time to the original sale transaction which was necessary to complete the desired purpose.

In this case the purpose of tax avoidance was absent. The sale by the Bank to Capital Company was made for the sole and exclusive purpose of settling a controversy with the Comptroller of the Currency in a manner which the Bank considered important to avoid establishing any precedent which might later be detrimental to it. The settlement of the controversy in the manner described was the purpose of the transaction; the intent of the Bank and Capital Company was that the sale should be a closed and completed transaction and that at least for a period of time the sale should be so effective as to divest the

Bank of all title and control of the property and to vest that complete title and control in Capital Company as the owner of the property; the intent had to comprehend such results would be accomplished by the sales transaction because it was only by such a transaction having such consequences that the Bank could accomplish its purpose, and be able to support its position that it did not make a mere paper transaction or write down of assets, but actually suffered a loss through a sale of property; the purpose of the arrangement with respect to the possible repurchase of the property was to have an understanding with Capital Company that the Bank could repurchase the property when and if it desired to do so, but the intent behind this repurchase understanding was that it should have no effect upon the original sales transaction and that it should have no legal or binding effect as an encumbrance on Capital Company's ownership of the property because again the ultimate purpose of avoiding precedent which might be detrimental to the Bank in the future required that there be no transaction which might alter the legal effect of the original sale.

As argued under the previous subheading of this argument, a disregard of the sale to Capital Company places a construction on the transaction as though it were a sale by the Bank to Merchants, which is in direct contravention of the purposes and intentions of the Bank. A sale by the Bank to Merchants was considered by the Bank but was rejected because it would not have accomplished what the Bank was trying to accomplish. (R. 91.) The Court cannot "im-

pose" upon a taxpayer a transaction which it did not execute, so the Tax Court has gone too far in disregarding the sale to Capital Company and imposing upon the Bank a transaction which it had deliberately refused to make.

The statute (Section 112) requires nothing more than that the cost shall exceed the selling price in order that there be a determination of loss from the sale of property. The question of intent, of realism, arises from principles established by case authority in applying the statute which principles were devised to prevent the deduction of losses from unrealistic transactions made solely for the purpose of defeating the revenue. It is respectfully submitted that in this case there was a sale from the Bank to Capital Company and the selling price was less than the cost of the property sold so that a loss was sustained by the Bank when a sale was made. The element of tax avoidance is not present so there is nothing to bring into play the principles devised to prevent tax avoidance.

In this case there was a later sale by Capital Company to Merchants, but before that sale was made, Capital Company was the owner of the property, in complete control of title and income, which income was included by it in its income tax returns and subjected to tax; Capital Company was bound by nothing more substantial than a moral commitment made with the Bank to resell the property to the Bank at its request, which commitment was made with the deliberate understanding that it was to be merely a moral commitment and not a legal and binding obligation,

and so again the agreement for resale was not such a reserved power to the seller which could vitiate the original sales transaction and the legal consequences thereof, nor did it have the effect of vitiating Capital Company's ownership of the property from the time it purchased until the time it sold. The very intent of the parties was that the repurchase arrangement should not have any effect upon the original sales transaction. There is no basis whatever under this analysis of the principles pronounced in the cases on the subject, for disregarding the sale from the Bank to Capital Company and the consequences of such sale under the tax statutes. The loss was sustained. There is no restriction against its allowance as a deduction under the statute so it should be allowed.

It is the appellant's view that the sale of its property to Capital Company must be recognized and that the loss sustained upon that sale must be allowed. Under this view of its case, the later sale by Capital Company to Merchants is of no consequence in a determination of the issue involved herein. However, since The Tax Court took the position that the sale should be construed as a sale from the Bank to Merchants, it is necessary to submit some discussion of the case on that premise since the appellant believes that even on that premise The Tax Court erred in refusing to allow a deduction for the loss sustained in the sale.

(g) The Sale of the Properties by Capital Company to Merchants Was a Complete and Bona Fide Transaction.

There is nothing complicated about the transaction whereby Capital Company sold the eight properties to Merchants in 1943. Paragraphs 5, 6 and 7 of the stipulation show that Capital Company sold the properties to Merchants for cash at a price equal to Capital Company's cost plus cost of acquisition, and show also that all legal formalities with respect to the transaction were complied with. (R. 34-38.)

The Tax Court had no complaint about the validity of this sale but in view of its position that Capital Company was "merely a conduit through which petitioner could transfer formal title to Merchants" (R. 137) and that "the sale must be viewed as being made between petitioner as vendor and Merchants as vendee" (R. 139) it ignored the transaction between Capital Company and Merchants.

III. THE BANK'S DOMINATION AND CONTROL OVER MERCHANTS AS ITS WHOLLY OWNED SUBSIDIARY CANNOT BE CONSTRUED AS DOMINATION AND CONTROL OVER THE ASSETS OF MERCHANTS, AND CANNOT JUSTIFY A DISREGARD OF THE CORPORATE ENTITY OF MERCHANTS.

After concluding that the transaction had to be viewed as a sale between petitioner and Merchants (R. 139) The Tax Court stated, "the question thus becomes what effect does the closeness of the relationship between petitioner and Merchants have upon the deductibility of the loss in question". (R. 139.) The Tax Court concluded the loss was not deductible

and it stated "The basis for the decision is the complete domination and control which petitioner continued to exercise over the properties transferred through its complete domination and control of its wholly owned subsidiary". (R. 141.) Expressing it in another way The Tax Court concluded "The facts clearly show that there is no substance to the sale of the branch banks by petitioner to its wholly owned subsidiary. Petitioner had complete domination and control over Merchants and the properties in the hands of Merchants were as much subject to petitioner's control as they were while legal title was in petitioner's own name. * * * In effect and substance Merchants was no more than the *alter ego* of petitioner, and 'no loss could occur upon a sale by a taxpayer to such an entity.' " (R. 142-143.)

There is no justification in fact or in law for the conclusion above quoted. Here are the facts as stipulated—

Merchants had a net worth during 1943 as shown by the Balance Sheet appearing as Schedule L, page 4, of its income tax return (Ex. 22-V, R. 111) of about \$19,000,000.00. It had rental income in 1943 of approximately \$982,000.00 and expenses and depreciation aggregating the same amount, so that it had no net income for tax purposes. (Ex. 22-V, R. 110.) It will never have a net taxable income because under a formal lease agreement executed between the Bank and Merchants *under date of August 1, 1936,* the rental payable by the Bank to Merchants is fixed at "an amount equal to the total of all expenses and charges of the lessor, which are allowable to the

Lessor, Merchants National Realty Corporation, as deductions from gross income for Federal income tax purposes, less an amount equal to the total income of the lessor derived from all souces other than the rental to be paid hereunder". (Lease Ex. 7-G, paragraph First, R. 73).[2] The lease also provided that "it is agreed that from time to time the Lessor and the Lessee may add to the parcels of property covered by this lease, by agreeing that the same shall become a part of the property covered hereby" * * * etc. (Lease Ex. 7-G, Paragraph Tenth, R. 77.)

The stipulation, paragraph 7, states "The properties deeded by Capital Company to Merchants as stated above, were thereafter held by Merchants under this lease". (R. 38.) This same paragraph of the stipulation shows that many of the officers and directors of the Bank were also officers and directors of Merchants, that Merchants had no salaried employees, and that whatever work was necessary to the operation of the Company's business was performed by employees of the Bank. (R. 38.) Nevertheless, Merchants, as a separate corporate entity, did own property, it did conduct a business of leasing its property to the Bank (Stip. paragraph 7, R. 38) and its business did require its expenditure of over $500,000 in 1943 for expenses of its business (Ex. 22-V, R. 110), and it maintained a bank account ranging from $2,184,000 at the beginning of 1943 to $290,000 at the end of the year. (Ex. 22-V, R. 111.) The purchase of

[2]But it could have book net income or net loss due to limitations under tax laws as for example the provision which prevents allowance of net capital losses—Sec. 117 (d) (1).

property by Merchants in 1943 and the leasing of the property to the Bank by adding it to property covered by the 1936 lease, is no different than what Merchants has been doing ever since the execution of the lease on August 1, 1936, and the lease itself contemplates just such transactions by making specific provisions therefor. (Ex. 7-G, paragraph Tenth, R. 77.)

Any parent of a wholly owned subsidiary has domination and control over the subsidiary by virtue of its stock ownership, but it has never been held that such domination and control alone justified a disregard for tax purposes of the corporate entity of the subsidiary or a disregard of transactions between the parent and the subsidiary. On the basis of this premise the only question is whether the lease arrangement between the parent and the subsidiary is so unrealistic as to justify a disregard of the corporate entity of the subsidiary? A complete answer to the question would seem to be a practical one, i.e., the lease had been in existence for years prior to 1943 and was not changed in 1943; and the sales transaction here under discussion was entered into in 1943 as a legal and realistic transaction consummated for a purpose entirely unrelated to tax considerations; so there is nothing so different in 1943 to justify the conclusion that in 1943 the corporate entity of Merchants should be disregarded and the Bank should be deemed to be the real owner of the property owned by Merchants. This practical answer should be the best and a sufficient answer, but there are even further answers. There are a number of cases, some of which

are briefed in the appendix hereto, where the business arrangements between the parent and the subsidiary were more unusual than the lease arrangement in this case and yet the Courts refused to disregard the corporate entities on that ground. There is no general rule that transactions between a parent and its subsidiary are to be ignored. The rule is that separate corporate identities must not be ignored. *National Carbide Corp. vs. Commissioner* (1949) 336 U.S. 422 (cited in appendix hereto).

There is very little difference in substance in the business arrangements between the Bank and Merchants and the business arrangements between the parent and the subsidiaries under consideration in the *National Carbide Corp.* case, supra. Since the Supreme Court ruled that those arrangements were not sufficient to justify a disregard of the corporate entity of the subsidiaries in the *National Carbide* case, the similar arrangements between the Bank and Merchants could not be sufficient to justify a disregard of the separate identity of Merchants.

The Bank urges that the transaction considered in this proceeding was a sale of property by it to Capital Company and the loss sustained as computed under the income tax statutes should be allowed as a deduction. If this Court should be of the same view as the Tax Court that the sale was a sale by the Bank to Merchants, then, as hereinabove just argued, the loss is still allowable as a deduction to the Bank because the corporate identity of Merchants cannot be ignored and there is no circumstance which is legally suffi-

cient to support a refusal to apply the income tax statutes under which this loss must be recognized as a deductible loss.

IV. CONCLUSION.

It is respectfully urged that the sale of the properties by the Bank to Capital Company was a real and bona fide sale, made for a purpose other than to obtain a tax deduction; that the arrangement for the repurchase of the property by the Bank and the sale of the property to Merchants is immaterial to the recognition of the sale to Capital Company; and that the loss resulting from that sale is an allowable deduction for income tax purposes. It is urged further that even if the transaction is viewed as a sale of property by the Bank to Merchants, the sale was a closed and completed transaction and the loss resulting therefrom must be recognized as a deductible loss for tax purposes. It is respectfully urged that the decision of the Tax Court denying this loss as a deduction should be reversed.

Dated, San Francisco, California,
June 1, 1951.

George H. Koster,
Attorney for Appellant.

Bayley Kohlmeier,
Of Counsel.

Appendix.

Appendix

In *Electric Auto-Lite Co.,* T. C. Memo Docket 111986, Aug. 4, 1943, the Court allowed a loss on the sale of stock of one subsidiary to another wholly owned subsidiary and remarked that it did not believe that *Higgins vs. Smith,* supra, should be regarded as a direction to disallow a loss resulting from a bona fide business transaction, the tax consequences of which were incidental to its purpose, and where neither subsidiary was organized or used as a tax-saving device. (See also *Laughton vs. Commissioner* CCA-9 supra, already discussed.)

The Tax Court cites cases, which have already been discussed, to support its position, and again it must be emphasized that all of these cases which support a disregard of corporate entity or a disregard of transactions are predicated on the factual premise that the intercorporate relationship or the questioned transactions were entered into for the sole purpose of avoiding tax liability.

Reference has already been made to the case of *Bancitaly Corporation,* 34 B.T.A. 494 in which intercorporate relationships were not recognized as a basis for disregarding an intercorporate transaction upon which some $10,000,000 of "unrealized" profit was subjected to tax—of course, there was no tax avoidance purpose in the intercorporate transactions. Likewise, in the case of *Helvering vs. Johnson,* supra, 104 F (2d) 140, a deduction for a loss was allowed on a sale by taxpayer to a corporation which he controlled

and 50% of whose stock he owned—again there was no evidence of tax avoidance as the sole purpose of the transaction. A like situation existed in the *Chisholm vs. Commissioner* case hereinbefore discussed, 79 F (2d) 14.

This Court in the case of *Commissioner vs. Eldridge* (1935) 79 F (2d) 629, allowed a loss on a sale of stock made by an individual to his wholly owned corporation where the facts showed that the sale was made on the advice of an accountant and the corporation was not organized for the purpose of engaging in transactions to reduce taxes and in this case the Court emphasized that the corporate entities could not be ignored.

In *Brost Motors, Inc.,* Docket No. 15505, T. C. Memo. Oct. 29, 1948, the taxpayer corporation transferred real property to another corporation which was controlled by the same stockholders, directors and officers who owned taxpayer corporation. The transfer was made for security reasons and not solely to reduce tax liability. The Tax Court allowed the loss resulting from the transfer of the property. The Commissioner contended that the loss was not a real loss because (1) the transaction was made solely for tax purposes and (2) it was between corporations controlled by the same interest. The Tax Court concluded that there was a business purpose for the transaction, that there was an unqualified sale and transfer of the property, and that the entity of the purchaser could not be ignored even if it was under common control with the seller.

The Tax Court reached a similar conclusion in the case of *Anderson-Clayton & Co.,* Docket No. 15255, T. C. Memo Aug. 18, 1948, in which case the determination made by the Commissioner in his deficiency notice was much the same as the determination made by the Commissioner in his deficiency notice issued in the instant case. One corporation sold certain properties to another corporation. A third corporation owned all of the stock of the selling company and 89.5 per cent of the stock of the purchaser, and in reliance upon this fact, the Commissioner argued that the loss to the selling corporation was not an allowable deduction because the transaction had no business purpose, merely transferred assets from one operating unit of the petitioner to another and was a sham. The Court found that there was a business purpose for the transaction and that "there is no sound reason for disallowing the loss which Memphis actually sustained in selling the assets to West Texas".

The principal criterion in these cases involving transactions between affiliated corporations seems to be whether the transaction was *effected solely* for tax purposes. (*Crown Cork International Corp.* 4 TC 19, aff'd. CCA-3-1945, 149 F (2d) 968, and the two T. C. Memo cases above discussed.)

In the case of *Commissioner vs. W. F. Trimble & Sons Co.* (CCA-3-1938) 98 F (2d) 853, one corporation sold stock to another corporation and the loss resulting from the sale was disallowed by the Government because the same stockholders owned

the stock of both companies. In allowing the loss the Court reaffirmed the general rule that a corporation and its stockholders are deemed separate entities and the corporate entity will not be disregarded except where "too close a relationship between two or more corporations offends a statute or circumvents public policy, or when necessary to prevent fraud, or where one company is nothing but an agent of another". The Court said that even though a tax reduction resulted from the loss sustained in the transaction between the companies, such a result in itself does not come within the offenses justifying a disregard of the corporate entity.

The case of *Moline Properties, Inc. vs. Commissioner,* 319 U.S. 436, hereinbefore discussed, is probably the leading case on the proposition that corporate entities cannot be ignored for tax purposes unless the corporation is a sham or unreal and is used in such a way that its form is a bald and mischievous fiction, intended only to accomplish tax avoidance.

In *Frank & Leder Co.* (1928) 13 B.T.A. 1 (revd on other grounds 44 F (2d) 147) the Board of Tax Appeals refused to disregard a sale where options were given for repurchase and for limitation of loss, the Board being of the opinion that since the original sale was occasioned by business considerations alone, the option contracts and repurchase could not affect the bona fides of the sale.

In the case of *U. S. vs. Joliet and Chicago R. Co.* (1942) 315 U.S. 44, revg. 118 F (2d) 174, the Supreme Court held that a corporation is taxable upon

income constructively received by it when rentals due to it as lessor are paid directly to its stockholders. To the same effect, *Commissioner vs. Western Union Telegraph Co.* (CCA-2-1944) 141 F (2d) 774.)

We could discuss a great many more cases to show refusal of the Courts to disregard corporate entities or refusal to treat stockholders and their corporations as single entities where no tax avoidance schemes were involved, even in cases involving peculiar arrangements between the stockholders and their corporations. (For example, *U.S. vs. Joliet & Chicago R. Co.* supra 315 U.S. 44; *Commissioner vs. Western Union Tel. Co., supra,* 141 F (2d) 774; *Mississippi River & Terre Bonne Railway* (1939) 39 B.T.A. 995 allowing a subsidiary a loss on sale of property which had been leased to a parent under a lease quite similar to the Bank-Merchants lease; *Porter Royalty Pool, Inc. vs. Commissioner,* (CCA-6-1948) 165 F (2d) 933; *Railway Express Agency* 8 T C 991 rev'd on other grounds; *National Investors Corp. vs. Hoey,* (CCA-2-1944) 144 F (2d) 466, (cited in *National Carbide Corp.* 336 U. S. 412, discussion of which follows, which gives an interesting discussion as a prelude to the conclusion that a Corporate form must be unreal or a sham or its businesses confined to tax evasion, before the Treasury Department may disregard it), but we think that the rule that a corporate entity may be disregarded because of the dominion and control over it by its stockholders has been abrogated completely by the Supreme Court in its decision in the case of *National Carbide Corp. vs. Commissioner* (1949) 336 U.S. 422.

In the *National Carbide Corp.* supra case the taxpayers were three wholly owned subsidiaries of Air Reduction Corp. (Airco) and they claimed that they were mere agents of their parent so their income should be treated as income of the parent. Airco operated the businesses of the individual companies and they paid to Airco all their profits in excess of 6% on their outstanding stock. Top officials of Airco held similar positions in the subsidiaries. The Tax Court held that the income of the subsidiaries in excess of 6% of their capital stock was income of Airco. 8 T.C. 594. The Court of Appeals, (2d) Circuit reversed and the Supreme Court granted certiorari "because of this conflict of opinion and the disagreement between Courts as to the continuing vitality of *Southern Pacific Co. vs. Lowe* 1918, 247 U.S. 330". In referring to the decision of the Court of Appeals, the Supreme Court said:

> *"It held under our decisions, when a corporation carries on business activity the fact that the owner retains direction of its affairs down to the minutest detail, provides all of its assets and takes all of its profits can make no difference tax-wise. The Court concluded that 'Even though Southern Pacific Co. vs. Lowe, supra, set up a different test, we regard it as pro tanto no longer controlling.'*
>
> "The result reached by the Court of Appeals is clearly required by our later decisions."

The Court pointed out that a subsidiary company might be an agent of its parent but a strict showing of such relationship would have to be made before

such relationship could be established for tax purposes. Mere dominion and control of the subsidiary either actual or through stock ownership is not sufficient to establish a relationship which the Supreme Court would recognize as an agency relationship for tax purposes.

No. 12881

In the United States Court of Appeals for the Ninth Circuit

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

THERON LAMAR CAUDLE,
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Special Assistants to the Attorney General.

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CITATIONS

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v.

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ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 119–143) are reported at 15 T. C. 544.

JURISDICTION

This proceeding involves a deficiency in federal income tax and a deficiency in declared value excess profits tax, both for the taxable year 1943, asserted against the Bank of America National Trust and Savings Association, herein sometimes referred to as the taxpayer. The taxpayer filed its corporation income and declared value excess profits tax return for the calendar year 1943 with the Collector of Internal Revenue for the First District of California on

March 14, 1944. (R. 103.) Under date of June 5, 1945, the Commissioner of Internal Revenue mailed to the taxpayer a notice of deficiency pursuant to Section 272 of the Internal Revenue Code. (R. 16–23.) Under date of August 21, 1945, the taxpayer duly filed with the Tax Court its petition for review of the Commissioner's determination of deficiencies (R. 3), and on May 28, 1946, leave therefor having been granted by the Tax Court (R. 3, 6–7), the taxpayer filed its amended petition for review of such determination (R. 7–15). On December 22, 1950, the Tax Court entered its decision (R. 143–144) sustaining the Commissioner's determination. The case is brought to this Court by a petition for review filed by the taxpayer on February 9, 1951. (R. 145–151.) The jurisdiction of this Court is invoked under Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether, under the facts, the taxpayer sustained a deductible loss for income tax purposes under Section 23 (f) of the Internal Revenue Code upon the transfer of legal title to eight of its banking premises in 1943 for a price less than the adjusted basis of such properties to it and the transferee of legal title, pursuant to a preexisting oral agreement with the taxpayer, transferred title to such properties to a wholly owned subsidiary of the taxpayer approximately thirty days later at the same price.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.23 (e)-1. *Losses by Individuals.*—

* * * * *

In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere form will govern in determining deductible losses. Full consideration must be given to any salvage value and to any insurance or other compensation received in determining the amount of losses actually sustained. See section 113 (b). For special provisions with respect to war losses, see section 127.

* * * * *

SEC. 29.23 (f)-1. *Losses by Corporations.*—Losses sustained by domestic corporations during the taxable year and not compensated for by insurance or otherwise are deductible insofar as

> not prohibited or limited by sections 23 (g), 23 (h), 24 (b), 112, 117, 118, and 251. The provisions of sections 29.23 (e)–1 to 29.23 (e)–5, inclusive, and section 29.23 (i)–1 are in general applicable to corporations as well as individuals. See section 232 as to deductions by foreign corporations. For special provisions with respect to war losses, see section 127.

STATEMENT

The Commissioner of Internal Revenue determined a deficiency of $915,040.93 in the income tax reported by the Bank of America National Trust and Savings Association for 1943 and a deficiency of $161,650.70 in the declared value excess profits tax reported by it for that year. (R. 16–23.) These deficiencies were based upon several adjustments made by the Commissioner to the taxpayer's reported income (R. 18), only one of which, a loss of $464,811.68 claimed by the taxpayer as having been sustained during the year on the sale of bank premises which the Commissioner disallowed, was challenged in the proceeding before the Tax Court (R. 120–121). Also, the Commissioner filed an amended answer in the Tax Court claiming an increase of $27,296.45 in the income tax deficiency and an increase of $4,822.17 in the declared value excess profits tax. (R. 26–27.) The taxpayer, by stipulation, accepted the adjustments to income on which the Commissioner's claim for increased deficiencies was based. (R. 41.) The Tax Court sustained the Commissioner's determination (R. 143), and the original deficiencies having been paid (R. 41), entered its decision redetermining

deficiencies in the amounts claimed by the Commissioner in his amended answer. (R. 143–144.)

The case was submitted to the Tax Court on a stipulation of facts (R. 31–41) and certain documentary exhibits, some of which (Exs. 1–A to 16–P, inclusive (R. 61–97)), were made a part of the stipulation and the remainder (Exs. 17–Q to 22–V, inclusive) were submitted in evidence by agreement of the parties (R. 98–116). The Tax Court found the facts as stipulated. They are fully summarized in the Tax Court's findings of fact (R. 121–133).

Taxpayer is a national banking association which was incorporated on March 1, 1927, under the laws of the United States. It operates a banking system in California through approximately 500 branches, and has its principal place of business in San Francisco. Title to some of the buildings in which the taxpayer conducts its banking business is held in the name of the taxpayer, and title to other such properties is held in the name of Merchants National Realty Corporation, a wholly owned subsidiary, hereinafter referred to as "Merchants". (R. 121.)

At all times pertinent to this proceeding, Merchants National Realty Corporation was a wholly owned subsidiary of the taxpayer. Many of the officers and directors of the taxpayer were also officers and directors of Merchants. The only business of Merchants was the ownership of property which it leased to the taxpayer. Merchants had no salaried employees. Whatever work was necessary to the operation of its business was performed by employees of the taxpayer. Merchants' place of business was in the head-

quarters of the taxpayer in San Francisco. (R. 121–122.)

The basic lease agreements under which the taxpayer leased property from Merchants (R. 72–78) provided that in exchange for a 10-year lease, the taxpayer would pay to Merchants as rent "an amount equal to the total of all expenses and charges of the Lessor, which are allowable to the Lessor, Merchants National Realty Corporation, as deductions from gross income for Federal income tax purposes, less an amount equal to the total income of the Lessor derived from all services other than the rental to be paid hereunder." (R. 122.)

On August 31, 1939, bank examiners from the office of the United States Comptroller of the Currency determined that the values of the banking properties in the books of taxpayer were in excess of their fair market value, and they recommended that the taxpayer be required to reduce the book values to the actual values of the banking properties in its books. The taxpayer refused to comply with the recommendation of the bank examiners and contended that the Comptroller of the Currency did not have the authority to require it to write down the value of any of its assets. After a number of conferences and exchanges of correspondence between the taxpayer and the Office of the Comptroller of the Currency (R. 61–72), an agreement was reached on March 6, 1940, as to the amount at which each banking property should be carried on the taxpayer's books. This agreement provided that "the unallocated reserve set up by the Bank [taxpayer] shall be reduced by the

difference between the present carrying value of each such premise and the value of such as determined by the committee [comprised of three Government banking officers]. * * * The remainder of such reserve, if any, may be returned to the undivided profits accounts." (R. 122–123.) In March, 1941, the taxpayer informed the committee that (R. 123):

> We will agree to establish a new cost basis for the bank premises listed in Exhibit "A" hereto attached in such manner as will result in a charge of approximately $1,000,000 against our profits for the period ending June 30, 1941, and a similar charge in the third quarter of 1941. The new cost basis to be established shall be determined from the American Appraisal Company appraisal, using the lowest appraisal of the American Appraisal Company as to the particular properties involved. No adjustment will be made as to properties with respect to which American Appraisal Company's most adverse appraisal exceeds book value.

The committee recommended that $2,000,000 be written off by the taxpayer in 1941 and $2,000,000 be written off in 1942. The Comptroller of the Currency accepted this proposal and informed the taxpayer to that effect. (R. 123–124.) The Comptroller also informed the taxpayer that (R. 124):

> Any or all of the amount may be charged to Undivided Profits instead of the Unallocated Reserve if desired, the amount of that Reserve, however, not to be reduced below $4,000,000 except after writeoff of the $2,000,000 in 1941 and approximately $2,000,000 in 1942.

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The taxpayer informed the Comptroller that these arrangements for a "reduction in book value of banking premises" were satisfactory to it. (R. 124.)

George H. Koster, one of the taxpayer's counsel, was asked by the taxpayer if he could advise it of a method whereby the Comptroller's requirement that the properties be written down could be met, without at the same time receding from the taxpayer's position that it was entitled to carry the properties at cost. He gave suggestions to the taxpayer which are recorded in a memorandum dated January 10, 1941. (R. 91–95, 124.)

The substance of this memorandum (R. 91–95) is that Mr. Koster first suggested as a means of reducing book values of such assets an arrangement for the purchase and sale of properties between the taxpayer and Merchants so that the purchase price would be a figure satisfactory to the committee and in accordance with the agreement; that the taxpayer's officers felt that since this was a transaction between the parent and a wholly owned affiliate the purchase and sale transaction might be ignored and the transaction considered a write-down which would establish a precedent whereby the taxpayer might be compelled to continue the practice of arbitrarily writing down the value of its banking premises, a precedent which the taxpayer did not want to establish; that Mr. Koster then suggested that if the taxpayer and Merchants would be willing to assume the risks which might result where property is removed from their hands, even for a short period of time, they might arrange

for some other company, such as Capital Company (a large real-estate company which was a wholly owned subsidiary of Transamerica Corporation, a substantial stockholder of the taxpayer), to purchase the property from one and then sell it to the other, as an accommodation, but that they should be compensated for the work involved in the transfers of the properties. The memorandum also shows that the results of such transactions from a tax standpoint were considered and discussed.

Koster and L. M. Giannini, president of the taxpayer, discussed the tax effects of the transactions and the results to be achieved by them with a representative of the Comptroller who informed them that the Comptroller could not pass upon the tax consequences of any of the transactions. (R. 124–125.)

Transamerica Corporation is a holding company. It owns substantial amounts of stock of many banks and industrial concerns. During 1941, 1942, and 1943, either Transamerica Corporation or its subsidiary companies owned common and preferred stock of taxpayer, each of which had equal voting rights. During 1941, 1942, and 1943, the outstanding common stock of the taxpayer amounted to 4,000,000 shares; and there was preferred stock outstanding in the amount of 540,000 shares in 1941, 460,796 shares in 1942, and 405,146 shares in 1943. Transamerica and its subsidiaries owned common and preferred stock of the taxpayer in 1941, 1942, and 1943 in the following amounts set forth below (R. 125–126):

Stock owned by Transamerica and subsidiaries

	1941	1942	1943
Common	899, 820	692, 394	570, 134
(Outstanding)	(4, 000, 000)	(4, 000, 000)	(4, 000, 000)
Preferred	500, 844	425, 174	370, 634
(Outstanding)	(540, 000)	(460, 796)	(405, 146)

Capital Company (hereinafter sometimes referred to as "Capital") is a wholly owned subsidiary of Transamerica Corporation and is engaged in the real estate business. (R. 126.)

Sometime in 1941, R. G. Smith, who was the executive vice-president of the taxpayer and the president of Merchants, conferred with E. C. Woodruff, the president of Capital. An agreement was reached between these two executives in behalf of their respective companies. (R. 126.) It was stipulated that this agreement provided (R. 35–36, 127–128):

> * * * That the Bank [taxpayer] or Merchants would execute deeds to Capital Company with respect to [certain] banking premises * * *; that Capital Company would accept delivery of such deeds; that Capital Company would deliver its checks to the Bank [taxpayer] and to Merchants in amounts equal to the value of said premises as appraised by the American Appraisal Company; that the Bank [taxpayer] intended to and would receive back, deeds to the said property within thirty days or so after delivery of deeds thereto to Capital Company, and Capital Company agreed to execute and deliver deeds to said property to the Bank or Merchants at any time upon request of the Bank; that there would not be any written agreement between the Bank, Merchants and Capital Company providing

> for the execution and delivery of deeds from Capital Company to the Bank or to Merchants; that when the Bank requested delivery of deeds to such property from Capital Company to it or to Merchants, the Bank or Merchants would give its check to Capital Company for the same amount of the check which Capital Company gave the Bank or Merchants for the respective property, plus acquisition costs incurred by Capital Company in connection with the transaction; and that between the time of the delivery of the deeds with respect to the respective properties from the Bank or from Merchants to Capital Company, and the time of the delivery of the deeds with respect to the respective properties from Capital Company to the Bank or to Merchants, the Bank would pay to Capital Company as rental amounts equal to 6% per annum net upon the amounts paid by Capital Company to the Bank or to Merchants, as aforesaid. * * *

Pursuant to this agreement, Merchants deeded four of the banking premises to which it held title to Capital in 1941, and Capital, in turn, deeded the properties to the taxpayer shortly thereafter. (R. 79.) The amounts paid by the taxpayer to Capital were the same as the amounts which had been paid by Capital to Merchants. Merchants showed losses from these transactions on its books and in its tax return in the total amount of $503,373.97. In 1942 Merchants similarly deeded ten of the banking premises to which it held title to Capital which, in turn, deeded them to the taxpayer for the same amounts which it had paid to Merchants. (R. 79.) Merchants showed losses from these transactions in the amount of

$463,593.85 on its books and in its tax return. (R. 128.)

In the year 1941, the taxpayer executed and delivered to Capital deeds to sixteen banking premises. About thirty days after each deed was delivered to Capital, Capital executed and delivered a deed to the same property to Merchants. The amounts received by the taxpayer from Capital were the same as the amounts which were paid to Capital by Merchants. (R. 79.) According to the taxpayer's books and tax return, these transactions resulted in losses to it in 1941 which totalled $1,383,039.64. In the year 1943, the taxpayer executed and delivered to Capital deeds to eight banking premises. About thirty days after each deed was delivered, Capital executed and delivered a deed to the same property to Merchants. The amounts received by the taxpayer from Capital for these properties were the same as the amounts received by Capital from Merchants. (R. 79, 128–129.) The eight transfers by the taxpayer in 1943, the details of which are set out in the Tax Court's findings (R. 130), resulted in an alleged loss of $464,811.68, which the taxpayer claimed in its return and which the Commissioner disallowed. The deductibility of this loss is the only issue involved here. (R. 131.)

In carrying out the above transactions, all formalities in connection therewith, such as the execution and recording of deeds, the affixing of documentary stamp taxes, the transfer of fire insurance, and the recording of the transactions on the books of all companies as purchases and sales of property, were com-

plied with. When the properties were deeded to Capital, the outstanding fire insurance policies covering the respective properties were amended by riders to provide that any loss payable thereunder should be paid to Capital; and when Capital deeded the properties to the taxpayer or to Merchants, the policies were again amended by riders to provide that any loss payable thereunder should be paid to the taxpayer or to Merchants, respectively. (R. 131.)

Upon the execution and delivery of the deeds to the respective properties by the taxpayer or Merchants to Capital, the taxpayer and Capital executed a "lease" agreement with respect to each property, which provided for the payment by the taxpayer to Capital of a "rental" equal to a return of 6 per cent per year to Capital on the money which it had paid out. (R. 131.)

All of the properties to which Merchants acquired formal title through Capital were immediately leased by Merchants to the taxpayer under the same form of a basic lease agreement between those parties as stated above. (R. 131.)

At all times pertinent to this proceeding, the banking properties which were the subject of the transactions involved herein were occupied and used by branches of the taxpayer. It was not contemplated at any time that there would be any interruption or change in the use and occupancy of the banking properties by the branches of the taxpayer which occupied them. (R. 131–132.)

In his notice of deficiency the Commissioner explained his reasons for disallowing the above deduction as follows (R. 19):

(1) Net loss claimed on the sale of assets other than capital assets includes losses of $464,811.68 on the sale of certain banking premises to the Capital Company. The Capital Company held legal title to these properties for a period of one month and received rent from you for such period of ownership. The properties were then sold by the Capital Company to the Merchants National Realty Corporation, your wholly owned subsidiary.

The Transamerica Corporation controlled all of the outstanding shares of the Capital Company. Approximately 22 per cent of your stock was owned by the Transamerica Corporation group.

Under date of August 1, 1936, you entered into an agreement with the Merchants National Realty Corporation whereby you leased from the Merchants National Realty Corporation certain banking premises. The rental was to be an amount equal to the total of all expenses and charges of the lessor allowable to said lessor as deductions from gross income for federal income tax purposes, less an amount equal to the total income of the lessor derived from all other sources. The result of this agreement is that all operations of the Merchants National Realty Corporation were merged with your operations, leaving no income of the Merchants National Realty Corporation subject to income tax.

It is held that no deductible loss resulted from the sale of banking premises to the Capital Company. Your taxable income is, therefore, increased $464,811.68.

On the basis of the foregoing facts the Tax Court found as a fact that (R. 133):

> Capital was merely a conduit through which petitioner [taxpayer] made formal transfers of the title to the eight properties involved in this proceeding to its subsidiary, Merchants. The transfers of title to the eight properties by petitioner [taxpayer] to Capital did not constitute bona fide sales of the parcels of property to Capital.
>
> Petitioner [taxpayer] at all times had complete ownership, dominion, and control over Merchants and over each of the eight parcels of property.

SUMMARY OF ARGUMENT

The Internal Revenue Code provides that in computing the taxable net income of a corporation there shall be allowed as a deduction, among others, losses sustained during the taxable year and not compensated for by insurance or otherwise. The loss, to be deductible, must be a real loss and the burden is upon the taxpayer claiming such deduction to prove that a loss was actually sustained during the taxable year. In order for a loss upon a sale of property to be deductible it must be a bona fide sale. Where an alleged sale of property is made as a part of a composite plan which includes an agreement for reacquisition of the property sold, and the plan is carried out, no deductible loss is incurred as a result of the purported "sale." It makes no difference that the property is to be reacquired by a subsidiary or a

close affiliate of the original seller rather than by the seller itself.

Here the taxpayer purportedly "sold" certain of its banking premises to Capital Company under an oral agreement previously entered with officers of Capital Company whereby Capital Company would reconvey the same properties at the same price to Merchants National Realty Corporation about thirty days later. This agreement between the taxpayer and Capital Company was purposely not reduced to writing but it was fully executed in the case of each transfer of property. Capital Company accepted title to the premises involved, and later transferred such title to Merchants purely as an accommodation to the taxpayer and the fact that the agreement to retransfer was not reduced to writing does not make the transfers to Capital Company completed sales which resulted in deductible losses.

The only purpose of these transfers of property, other than a possible tax saving which might result, was to effect a reduction in the net book value of its banking facilities as required by the Comptroller of the Currency, but in a way chosen by the taxpayer. The properties were transferred to Capital Company at a price less than the taxpayer's adjusted basis for computing gain or loss thereon, and were retransferred to Merchants at the same price. Under the facts of this case the transfer of title to the properties involved to Merchants did not result in a deductible loss to the taxpayer.

ARGUMENT

I

The Tax Court did not err, under the facts, in holding that the taxpayer did not sustain a deductible loss for the taxable year 1943 on the transactions here involved

In this proceeding the taxpayer is claiming a deduction of $464,811.68[1] from its gross income for 1943 as a loss allegedly sustained during that year, under the circumstances stipulated by the parties, upon the transfer of banking premises occupied by eight of its branch banks. The deduction is claimed under Section 23 (f) of the Internal Revenue Code, *supra,* which provides that in computing taxable net income of a corporation there shall be allowed as a deduction from gross income, "losses sustained during the taxable year and not compensated for by insurance or otherwise."

It has long been settled that deductions from gross income and exemptions from tax are granted only as a matter of legislative grace; that statutes granting such deductions or exemptions are to be strictly construed; and that the burden is upon the taxpayer claiming exemption or a deduction from gross income to bring himself squarely within the provisions of

[1] The taxpayer admits that the amount actually deductible would be subject to recomputation as a result of this Court's decision in *Bank of America National Trust & Savings Assn.* v. *United States*, 168 F. 2d 399, certiorari denied, 335 U. S. 827, which would affect the basis for computing losses in this case if it is eventually held as a matter of law that the transactions involved resulted in deductible losses (R. 46–49, 56).

the statute granting such relief.[2] It likewise is equally well settled, as will more fully appear from the following discussion, that any alleged loss, to be deductible for income tax purposes, must be actually "sustained" by the taxpayer.[3] Finally, the question whether a deductible loss has been sustained is essentially a question of fact to be determined in the first instance by the trial court, leaving for determination by the appellate court only the question whether the trial court's conclusion was "clearly erroneous." Rule 52 (a) of the Federal Rules of Civil Procedure. *Barnhart-Morrow Consol.* v. *Commissioner,* 150 F. 2d 285 (C. A. 9th); *Motter* v. *Wallace,* 72 F. 2d 678 (C. A. 10th).

The substantive requirements of deductibility of an alleged loss are succinctly stated in the Treasury Regulations promulgated under the Internal Revenue Code. Section 29.23 (e)–1 of Regulations 111, *supra,* relating to losses sustained by individuals and not compensated for by insurance or otherwise, aptly states that in general losses for which an amount may be deducted from gross income must be evidenced by "closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed." Section 29.23 (f)–1 of Regulations 111, *supra,* provides that, so far as material, the provisions of the Regulations relating

[2] *Burnet* v. *Houston*, 283 U. S. 223, 227; *Woolford Realty Co.* v. *Rose*, 286 U. S. 319, 326; *Ilfeld Co.* v. *Hernandez*, 292 U. S. 62, 66; *Deputy* v. *du Pont*, 308 U. S. 488, 493; *Helvering* v. *Northwest Steel Mills*, 311 U. S. 46, 49.

[3] *Burnet* v. *Huff*, 288 U. S. 156, and cases cited; *Gregory* v. *Helvering*, 293 U. S. 465.

to the deductibility of losses sustained by individuals are generally applicable as well to corporations.

Since, as stated above, the question whether a deductible loss has been sustained within the meaning of the taxing statute is primarily a question of fact to be determined in the first instance by the trial court on the basis of the evidence before it, the only useful purpose which could be served by a review of any or all of the great number of decided cases involving deductibility of alleged losses is to demonstrate the applicability of the above principles to the facts of the particular case under consideration. And when the facts of the instant case are considered in the light of the above principles it will be seen that the decision of the Tax Court herein not only is not "clearly erroneous", but that it is clearly right. In other words, the complete answer to the taxpayer's protestations of error on the part of the Tax Court, and its lengthy and somewhat repetitious argument (Br. 14–73), is that the taxpayer did not suffer any real loss as a result of the circuitous transactions upon which it bases its claim for deduction.

The stipulated facts in this case (R. 31–41) plus the documentary exhibits introduced in evidence (R. 61–116), clearly show that there was no real disposition by the taxpayer, or even an intended disposition, of the branch banking properties on which the loss here involved is claimed. No real loss was suffered. On the recommendation of his bank examiners the Comptroller of the Currency required the taxpayer to write down or charge off a substantial amount from the book value of its banking premises account. The tax-

payer contended that the Comptroller of the Currency had no authority to make such a demand upon it. But in a circuitous way the taxpayer complied with the Comptroller's demand, and that is the only substantive thing accomplished by the transactions outlined above. In its opinion the Tax Court held (R. 140, 142) that the Comptroller of the Currency had authority to require this reduction in the book value of the taxpayer's banking facilities. But whether there was authority for the Comptroller's requirements does not appear to be material here. As stated, the taxpayer did comply with them. The mechanics adopted by the taxpayer to effect these requirements of the Comptroller constitute the basis of its claim for a loss deduction for 1943, which is the year involved here. But, as we will show below, in addition to the requirements of the Comptroller the taxpayer also had tax savings in mind when it adopted these mechanics.

The taxpayer very aptly prefaces its argument with the statement (Br. 14) that the relationship between the parties to the sales transactions here involved is of primary importance in determining whether the decision of the Tax Court is right or wrong. It was this relationship between the corporations involved, and their officers, which made it possible for the taxpayer to accomplish in the manner it did the reduction in book value of its banking facilities as required by the Comptroller of the Currency without incurring any risk of actual loss of such properties. It was this relationship between the parties, and the arrangements which the taxpayer was able to make before it

transferred any of its banking properties,[4] which led to the affirmative finding by the Tax Court (R. 133) that Capital Company was merely a conduit through which the taxpayer made formal transfers of title to the eight properties here involved and that these transfers of title did not constitute bona fide sales of those particular properties to the Capital Company.

A substantial part of the taxpayer's argument (Br. 17–68) is devoted to the proposition that the Tax Court erred in finding (R. 133) that the sales of these particular branch banking premises to the Capital Company were not bona fide sales, but that Capital Company merely served as a conduit through which legal title was transferred to Merchants National Realty Corporation, the taxpayer's wholly owned subsidiary. Throughout its argument the taxpayer insists that this circuitous means of reducing the book value of its banking premises was not prompted by any tax saving motive. Its argument is that this method of complying with the requirements of the Comptroller of the Currency was adopted solely to avoid setting a precedent which might be embarrassing in the future because it did not agree that the Comptroller could require it to write down the book value of its banking premises. Br. 18, 19, 20, 25, 28, 36, 39, 41, 45, 47, 52, 55, 56–57, 62, 64–65, 66, 71.)

[4] Similar transfers of branch banking premises, either from the taxpayer to National Merchants Realty Corporation, or vice versa, during 1941 and 1942, through Capital Company (R. 34–37, 39), which were executed for the same general purpose, are not involved here. Apparently the tax liability for those years involving this issue is pending before the Bureau of Internal Revenue on refund claims. (R. 46.)

But this argument is not very convincing because the taxpayer did establish a precedent which would be as effective in the future, so far as the Comptroller of the Currency is concerned, as if it had simply written down the book value of its banking premises. The record clearly shows that the Comptroller of the Currency was not interested in the method adopted by the taxpayer in complying with his requirements. Any method adopted then would seem to set a precedent, if that was the taxpayer's chief worry, as it would have this Court believe, if the Comptroller of the Currency should see fit to require a similar reduction of book values at a future date.

Also, there is no merit to the taxpayer's repeated assertion that there was no tax motive involved in the method selected to effect the reduction in book values required by the Comptroller of the Currency. The memorandum of the taxpayer's tax counsel (R. 91–95) clearly shows that taxes were a major consideration. In fact, on the record as a whole, there is more justification for claiming that the method adopted by the taxpayer to effect a reduction in the book value of its branch banking properties was solely for the purpose of securing a loss deduction than there is for the taxpayer's contention that the method adopted was solely to spite the Comptroller of the Currency. In our opinion the Tax Court indulged in understatement when it said (R. 140): "The evidence shows that possible tax advantages were an important consideration in arriving at the complicated form in which the simple requirement of the Comptroller was met." However, the Tax

Court's decision was not based upon any intent on the part of the taxpayer to effect a tax saving while complying with the requirements of the Comptroller. It was based upon the conclusion, from the evidence, that no loss was actually sustained by the taxpayer as a result of the transactions here involved. As the Supreme Court said in *Minnesota Tea Co.* v *Helvering,* 302 U. S. 609, 613, "A given result at the end of a straight path is not made a different result because reached by following a devious path."

In its opinion the Tax Court relied to some extent upon the decisions of the Supreme Court in *Higgins* v. *Smith,* 308 U. S. 473; *Gregory* v. *Helvering,* 293 U. S. 465; *Burnet* v. *Huff,* 288 U. S. 156; and *Weiss* v. *Wiener,* 279 U. S. 333. (R. 134, 139, 143.) The taxpayer admits (Br. 27–28) that *Burnet* v. *Huff* and *Weiss* v. *Wiener, supra,* stand for the proposition that a loss from an alleged sale must be real and actual. That should be a sufficient answer here because the facts show that this taxpayer did not sustain an actual loss in the transfer of the eight banking premises to its wholly owned subsidiary. We cannot agree with the taxpayer (Br. 27–28) that these decisions are of no help in determining the issue here involved.

The taxpayer then proceeds to argue (Br. 28–38) that the decisions in *Gregory* v. *Helvering* and *Higgins* v. *Smith, supra,* are inapplicable here because the transactions which the courts held should be disregarded in those cases were entered into solely for tax saving purposes, while the transactions involved in this proceeding had no tax saving motive. The

taxpayer is wrong in insisting that there was no tax saving motive behind the transfers of property here involved. But laying aside any consideration of tax saving, it is clear that these two decisions, and many which have followed them, are not based primarily upon the tax saving motive which prompted the transactions involved in those cases. In *Gregory* v. *Helvering, supra,* the Supreme Court, after pointing out (p. 469) that a taxpayer has a right to minimize or avoid his taxes by any means which the law permits, said: "But the question for determination is whether what was done, *apart from the tax motive,* was the thing which the statute intended." (Italics supplied.) The Court then added that the "reasoning of the court below in justification of a negative answer leaves little to be said." The opinion of the Court of Appeals for the Second Circuit in that case [5] makes it clear that the presence of a tax saving motive was not the only consideration in its decision. This is strengthened by the recent opinion of Judge Learned Hand (who wrote the Court of Appeals opinion in the *Gregory* case) in *Commissioner* v. *Transport, Trad. & Term. Corp.,* 176 F. 2d 570, certiorari denied, 338 U. S. 955, where he said (p. 572):

> The doctrine of *Gregory* v. *Helvering, supra,* which we here hold to be controlling, is not limited to cases of corporate reorganizations. It has a much wider scope; it means that in construing words of a tax statute which describe commercial or industrial transactions we are to understand them to refer to transactions entered

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[5] *Helvering* v. *Gregory,* 69 F. 2d 809.

> upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation.

Incidentally, it should be noted that the Supreme Court denied certiorari in the *Transport Trading & Terminal Corp.* case, *supra,* on February 13, 1950, after it had decided *United States* v. *Cumberland Pub. Serv. Co.,* 338 U. S. 451, also relied upon by the taxpayer (Br. 48–49). The only respect in which the latter case seems to be applicable here is that it emphasizes the factual nature of cases of this character and that the decision of the trial court should not be reversed unless clearly erroneous.

We submit that, despite the taxpayer's argument (Br. 47–68), the Tax Court correctly held (R. 137) that the facts in this proceeding show beyond any doubt that there were no real and complete sales of any of the banking properties to Capital Company by the taxpayer in the taxable year here involved which resulted in a deductible loss for tax purposes. It is true that legal title to the properties was transferred to Capital Company in 1943. But in determining whether a loss on an alleged sale has been sustained for tax purposes the transfer of title is only one of the elements to be considered. Prior to any transfers of banking premises to Capital Company in 1941, either by the taxpayer or by Merchants National Realty Corporation, the taxpayer entered into an oral agreement with the president of Capital Company (R. 35–37) which, if carried out, would insure the taxpayer against losing dominion and control over any of the transferred banking premises,

even during the brief period that title was lodged in Capital Company, and would insure the reacquisition of title by the taxpayer or its wholly owned subsidiary after the lapse of the brief period of thiry days or so. In each instance, in 1941 and 1942 as well as for the year here involved, where title to one of the taxpayer's branch banking premises was transferred to Capital Company by the taxpayer or by Merchants the title was retransferred to ~~one or~~ the other by Capital Company about thirty days later. In each instance the particular branch bank continued to occupy the premises under a so-called "lease" agreement (R. 36, 38, 81–87) under which, for the short period during which title was in Capital Company, the latter received from the taxpayer as "rental" an amount equal to 6% per annum on the price at which the property was transferred to Capital Company. In making this agreement with the taxpayer the officers of Capital Company were assured that in the case of any transfer of title to Capital Company the taxpayer "intended to and would receive back" deeds to the property within thirty days or so after such deeds were delivered to Capital Company (R. 36).

It is clear from the record, and the taxpayer does not contend otherwise, that in executing these transfers of title to Capital Company the taxpayer had no intention of parting with title to the properties involved or of surrending dominion or control over them. Capital Company accepted and re-transferred title to these properties solely as an accommodation to the taxpayer. It was compensated by the tax-

payer for these accommodation services and properly reported such compensation as income in its tax returns. (R. 38.) But it does not follow, as contended by the taxpayer (Br. 45), that by taxing the Capital Company on this income the Commissioner has in any way recognized the transfers of title to Capital Company as completed sales of the properties involved. The transfers of title to Capital Company were not completed and closed transactions, despite all the efforts of the taxpayer to make them appear as such. These transfers were merely steps in the taxpayer's plan to reduce the book value of the banking premises involved in some way other than a simple write-down of those values—which clearly would not provide any basis for a tax deduction. The taxpayer did not intend to, and did not, part with control and dominion over these properties. As the Tax Court pointed out (R. 136), where a sale is made as a part of a composite plan which includes, as in this proceeding, an agreement for reacquisition of the property sold, and the plan is carried out, any alleged loss suffered as a result of the "sale" of the property is not deductible. See *Du Pont* v. *Commissioner,* 118 F. 2d 544 (C. A. 3d), certiorari denied, 314 U. S. 623; *Foster* v. *Commissioner,* 96 F. 2d 130 (C. A. 2d); *Shoenberg* v. *Commissioner,* 77 F. 2d 446 (C. A. 8th), certiorari denied, 296 U. S. 586; *Commisisoner* v. *Dyer,* 74 F. 2d 685 (C. A. 2d), certiorari denied, 296 U. S. 586. Furthermore, it makes no difference whether, as here, the property is to be reacquired by a subsidiary or close affiliate of the original seller rather than by the seller itself. *Rand* v. *Helvering,*

77 F. 2d 450 (C. A. 8th); *John M. Burdine Realty Co.* v. *Commissioner,* 20 B. T. A. 54.

The taxpayer argues (Br. 38–47), contrary to the finding of the Tax Court (R. 133), that it lost dominion and control over the banking premises which it transferred to Capital Company because the agreement for retransferring title thereto to Merchants National Realty Corporation was oral and could not have been enforced. It relies upon Sections 1971 and 1973 of the California Code of Civil Procedure (Br. 44), which require such agreements to be in writing. However, counsel failed to mention Section 1972 of the Code of Civil Procedure, which provides Section 1971 must not be construed to abridge the power of any court to compel the specific performance of an agreement in case of part performance thereof. But whatever defense Capital Company might otherwise have had by reason of the fact that its agreement to retransfer to Merchants was not in writing, the fact remains that this agreement was fully executed in each instance by the transfer of title to Merchants approximately thirty days after title was transferred to Capital Company by the taxpayer. And it is well settled in California that no attack can be made upon a contract under the statute of frauds after it has been fully performed. See *James* v. *Hall,* 88 Cal. App. 528, 264 Pac. 516; *Atkinson* v. *Boynton,* 97 Cal. App. 759, 276 Pac. 356; *McComsey* v. *Leaf,* 36 C. A. 2d 132, 97 P. 2d 242. We submit that to accept the taxpayer's argument under the facts of this case would be to prefer form over substance.

The taxpayer cites or quotes from a large number of other decisions in support of its argument that the transfers of banking premises were closed and complete transactions for the purpose of establishing a deductible loss. (Br. 34–67.) An extended review of these decisions could serve no useful purpose because, like the instant case, the decision in each case depended primarily upon the facts of the particular case and can be readily explained or distinguished. The taxpayer lays particular stress (Br. 60–63) upon the decision of the Board of Tax Appeals (now the Tax Court) in *Bancitaly Corp.* v. *Commissioner,* 34 B. T. A. 494, appeal dismissed, 121 F. 2d 452 (C. A. 9th). But, as the Tax Court pointed out (R. 137–138), there is little similarity between the instant proceeding and that in the *Bancitaly Corp.* case in either the matter of facts or the issue involved. In the *Bancitaly Corp.* case the bank sold 150,000 shares of stock and subsequently reacquired 84,198 of the shares which it had sold. The issue in the case was whether the bank had realized taxable income upon the sale of the 84,198 shares which it subsequently repurchased. In that case the Board expressly found, from the evidence before it, that the sale of the 150,000 shares of stock and subsequent repurchase of 84,198 of those shares were separate and independent transactions and that the original purchaser was under no obligation to resell any of the shares to the bank. A similar finding here clearly is not warranted by the evidence in the instant case.

The agreement between the taxpayer and Capital Company under which Capital Company agreed to

accept title to the banking premises from the taxpayer or Merchants and retransfer such title to the other corporation some thirty days later purposely was not reduced to writing. (R. 34–37.) The only plausible explanation for this gentlemen's agreement is that it was thought by the taxpayer that not reducing this agreement to writing might give the transfers a color of reality. Whether this added color of reality was sought for the taxpayer's gratification in its dealings with the Comptroller of the Currency, as the taxpayer maintains, or whether it was sought for tax purposes, which seems more logical since the Comptroller did not care how the reduction in book value of its banking facilities was accomplished, it is clear from the record that any risk which the taxpayer assumed as a result of the outwardly unqualified transfers of property to Capital Company was negligible. The relationship of the parties was such as to assure full compliance with this oral understanding. According to the taxpayer's own statement (Br. 61–62), Bancitaly Corporation, mentioned above, was a predecessor of Transamerica Corporation, which prior to 1937 owned all of the stock of the taxpayer. The stipulation (R. 39–40) shows that Capital Company was a wholly owned subsidiary of Transamerica Corporation, and that in 1943 Transamerica Corporation and its subsidiaries still owned about 22% of the outstanding stock of the taxpayer. Joint Exhibit 15–0 (R. 95–96) shows that L. M. Giannini was a director of Merchants National Realty Corporation in 1943. Joint Exhibit 16–P (R. 96–97) shows that A. P. Giannini was chairman of the board of directors

of the taxpayer and that L. M. Giannini (son of A. P. Giannini) was president,[6] chairman of the general executive committee, and a director of the taxpayer during 1943. The annual report of Transamerica Corporation (Joint Exhibit 19–S, not printed) for 1943 also shows that A. P. Giannini was chairman of the board of directors of that corporation in 1943 and that L. M. Giannini was a director and a member of the executive committee. What other connection, if any, existed between the two groups of corporations is not shown by the record, but this is sufficient to indicate that the oral agreement to reconvey, whatever its purpose, would be carried out. The best proof of good faith, however, is that reconveyances were made in each case as agreed upon.

II

The transfers of title of banking premises to its wholly owned subsidiary in 1943 did not result in a deductible loss to the taxpayer

The taxpayer finally argues (Br. 68–73) that even if the temporary transfer of title to the banking premises involved to Capital Company in 1943 did not constitute closed and completed transactions for tax purposes it nevertheless sustained a deductible loss on the ultimate transfer of those properties to Merchants National Realty Corporation, its wholly owned subsidiary. The substance of its argument seems to be that regardless of any other considerations involved

[6] See also annual reports of the Bank of America (Joint Exhibits 17–Q and 18–R, not printed in the record) for the years 1942 and 1943.

the separate corporate identity of the taxpayer and Merchants cannot be disregarded for tax purposes. We think enough already has been said to show the fallacy of this argument. The deduction was disallowed because, under the facts, no real loss was sustained by the taxpayer. The situation is not comparable with the situation in those cases, some of which are cited in the Appendix to the taxpayer's brief, where transactions between controlled corporations or between a wholly owned corporation and its stockholders were found to be genuine business transactions. For instance, *National Carbide Corp.* v. *Commissioner,* 336 U. S. 422, so emphatically relied upon by the taxpayer (Br. 72, Appendix v-vi), does not stand for the rule, as asserted by the taxpayer "that separate corporate identities must not be ignored." Neither the corporations involved nor the Commissioner sought to ignore the separate identity of the participating corporations. The corporate taxpayers involved in that case were operating subsidiaries of Air Reduction Corporation, which received all of their net operating income over and above a 6% return on their capital stock under an operating contract with the subsidiaries. The only question decided by the Supreme Court was whether the operating companies received and paid over to the parent this income as agents of the parent or as operating taxpayers.

There is nothing in *National Carbide Corp.* v. *Commissioner, supra,* or any other of the cases cited by the taxpayer in its Appendix which would justify a holding here that the taxpayer sustained a loss by

the mere transfer of title to some of its banking premises to Merchants. The transfers were entirely without substance so far as the operation of the taxpayer's banking business was concerned. Merchants National Realty Corporation served no function other than to hold title to some of the taxpayer's banking premises. (R. 38.) It did not even hold title to all of such properties. (R. 34.) Those properties to which Merchants did hold title, including those to which title was transferred to it in 1943, were leased to the taxpayer under a blanket lease agreement executed in 1936 which left it impossible for Merchants to realize any gains or losses from the ownership of such properties. Under the circumstances here involved it could make no practical difference in the operation of the taxpayer's banking business whether the title to its banking premises was held by it or Merchants. We fail to see where the various transfers of title between the taxpaper and Merchant, both in the year here involved and in the preceding years, served any business purpose other than to effect a reduction in the net book value of such properties as required by the Comptroller of the Currency and provide a basis for this tax claim. We fail to see where the extent of Merchants' net worth, the volume of its so-called rental income and deductions, and the size of its bank balance, all emphasized by the taxpayer (Br. 69–70) could have any bearing upon the question here involved. The taxpayer did not make any disposition of banking premises during the year here involved which resulted in a deductible loss to it.

CONCLUSION

The decision of the Tax Court is right. It is fully supported by the facts and the law. Since the taxpayer has failed to show that it is "clearly erroneous," it should be affirmed.

Respectfully submitted.

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No. 12,881

IN THE

United States Court of Appeals

For the Ninth Circuit

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, *Appellant,* vs. COMMISSIONER OF INTERNAL REVENUE, *Appellee.*	

APPELLANT'S REPLY BRIEF.

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No. 12,881

IN THE

United States Court of Appeals
For the Ninth Circuit

Bank of America National Trust and Savings Association, *Appellant,* vs. Commissioner of Internal Revenue, *Appellee.*	

APPELLANT'S REPLY BRIEF.

The Commissioner of Internal Revenue, the Respondent or Appellee in this case, insists in his brief that this case is essentially a question of fact and that The Tax Court cannot be reversed unless its conclusions as to the facts are "clearly erroneous" (Br. p. 18). He argues that The Tax Court's conclusions are clearly right and that the taxpayer did not sustain a loss on the sale of its property, and The Tax Court's decision therefore should be sustained (Br. p. 19). He also argues that tax-savings was the motive for making the sale (Br. p. 22) and that a transaction so motivated should be disregarded as having no real

Table of Authorities Cited

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APPELLANT'S REPLY BRIEF.

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business purpose and not bona fide, and therefore The Tax Court decision is correct.

If there is a sale of property, a loss is sustained when the selling price is less than the cost (Int. Rev. Code, Sec. 112(a) and 111(a)). In this case it is stipulated that the selling price was less than cost, so there is no merit to the Government's argument that no loss was sustained. The loss is deductible unless the sale transaction can be disregarded as The Tax Court concluded, as not being a bona fide sale.

The Tax Court said the sale of the property was not bona fide. As Appellant pointed out in its Opening Brief (pp. 17-38), there is no justification in fact or law or judicial authority for this conclusion. To support such a conclusion it must be shown that the sale was made solely for tax-saving purposes, and there is absolutely nothing in the record from which such a showing can be made. The stipulation shows that a tax reduction resulted from the loss but it does not show that the sale was made for the purpose of obtaining the tax reduction (Op. Br. p. 20-25).[1] The sole

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[1]The loss results in an immediate tax reduction of approximately $180,000.00, (40% of claimed loss of $464,811.68). This is not an extraordinarily large amount when compared with the Bank's tax liability for 1943 of $6,041,163.77 (R. 23), and it is not a true "saving". The basis of the property to Merchants is the price which it paid for the property so its basis for depreciation and for computing gain or loss on subsequent sale is lower than the basis that the property had in the hands of the Bank. It might very well turn out that the transaction will result in a greater tax rather than a tax saving. This point was emphasized by the Court of Appeals for the 2nd Circuit in *Commissioner vs. Behan* (1937) 90 F(2d) 609, in commenting upon whether a tax reduction from a transaction in which a new basis is established can be considered a tax savings.

purpose of the sale was the settlement of the controversy with the Comptroller.

There is an inclination on the part of the Government to belittle the seriousness of the controversy with the Comptroller. We did not want to fill the record with the entire story about that controversy but the record indicates that there were other matters involved (the reference to the settlement of the bank premises valuation issue being referred to as "paragraph 5 of Requirements of the Comptroller" (R. 61-63)), and that the settlement of the controversy had been the subject of "extended negotiations" (R. 66), and that the Bank was extremely concerned about protecting its position and the principles it was advocating in the controversy. Whether the Bank's position in this controversy with the Comptroller was tenable, or whether its insistence on avoiding any move which could be referred to as a precedent detrimental to its interests would afford legal protection in the future, is immaterial to the consideration of this case. What is material and important, is the fact that the Bank had decided that such action was imperative for its protection, and was willing to go to the trouble and expense of making the sales involved in this case to carry out this decision. The sole purpose of these sales was to carry out this decision and the stipulation so provides. This must be recognized as a real business purpose as the Bank intended it to be. The Government's brief does not refute this conclusion.

In the very recent case of *Rollingwood Corp. vs. Commissioner,* No. 12728, June 21, 1951, this Court stated: "Rule 52(a) of the Federal Rules of Civil Procedure is plain in its requirements that findings of fact shall not be set aside unless clearly erroneous. It is true that where the facts are not in dispute this Court may draw inferences of its own. But the ultimate question is whether the findings are supported by the record," and the Court proceeded to show how the record established the fact as found by The Tax Court that certain houses were held for the purpose of sale. The stipulated facts supported such a finding. In this case, however, the stipulated facts contain the stipulation that the purpose of the sale transaction was to effect a settlement of the controversy with the Comptroller (Op. Br. p. 20-25), so any finding that the sale was made for the sole purpose of saving taxes would be in direct conflict with the stipulated facts and therefore "clearly erroneous," and without such a finding The Tax Court's decision in this case cannot be sustained (Op. Br. p. 8-14).

In the opening brief we pointed out that once the sale is recognized as bona fide the deductibility of the loss cannot be affected by the sale of the property by Capital Company to Merchants (Op. Br. p. 58-67). The cases cited by the Commissioner to support a position contrary to this conclusion have been analyzed in the Appellant's opening brief. (*Shoenberg vs. Commissioner, Commissioner vs. Dyer, Rand vs. Helvering,* Op. Br. 59; and the *Foster vs. Commis-*

sioner and *DuPont vs. Commissioner,* are in principle the same as the other cases involving sales between family members and reacquisition of the property originally sold where the transaction when originally made involved an agreement to repurchase). In all those cases there was no other motive for the sale than tax reduction and the repurchase agreement was an essential part of the transaction. That is not the kind of a case now before this Court.

If the sale from Capital Company to Merchants had been a necessary incident to accomplish the Bank's purpose in making the sale to Capital Company, the arrangement for the later sale might have justified a disregard of the intermediary transaction, but in this case it was the sale from the Bank to Capital Company which was necessary for the accomplishment of the Bank's purpose, the meeting of the Comptroller's requirement, and the sale from Capital Company to Merchants had no relationship whatever to that objective (Op. Br. p. 47-58). The sale from the Bank to Capital Company stands by itself and must be considered as a single bona fide transaction (*J. Harold Frantz,* BTA Memo, and *Bancitaly Corp.,* cited p. 60 of Op. Br.). In that light, the sale to Capital Company must be recognized and the loss resulting therefrom must be allowed, and the decision of The Tax Court should be reversed.

The Commissioner takes issue with our interpretation of the *National Carbide Corp. vs. Commissioner* case, 336 U. S. 412 (Op. Br. App. vi). We argued

that under this case affiliated companies had to be recognized as separate taxpayers regardless of their close relationship and the domination and control of one over the other. We pointed out that so long as the separate corporate entities must be recognized the usual incidents of taxation are applicable even as to transactions between them. In this case the Supreme Court in referring to the case of *Southern Pacific Co. vs. Lowe,* 247 U. S. 330 stated:

> "It is thus clear beyond doubt that the subsidiary was not referred to as an agent of the parent in the usual or technical sense. 'Agency' and 'practical identity,' as those words are used in the *Southern Pacific* case, are unquestionably opposite sides of the same coin. The close relationship between corporations because of complete ownership and control of one by the other was the basis for the result reached, whatever its articulation.
>
> "That basis has been repudiated by subsequent decisions of this Court. Whatever the vitality of *Southern Pacific Co. v. Lowe* on its special facts, we have held that a corporation formed or operated for business purposes must share the tax burden despite substantial identity, in practical operation, with its owner. Complete ownership of the corporation, and the control primarily dependent upon such ownership—the important ingredients of the Southern Pacific case—are no longer of significance in determining taxability. *Moline Properties, Inc., v. Commissioner,* supra; *Burnet v. Commonwealth Improvement Co.,* 1932, 287 U. S. 415, 53 S.Ct. 198, 77 L.Ed. 399.
>
> "In both of the cases last cited, the agency argument now urged upon us was made and re-

jected. In both cases, *Southern Pacific Co. v. Lowe,* supra, was relied upon by the taxpayers. In both, we found that the contention that the corporation was the agent of its owner was simply the argument that the subsidiary had no corporate identity distinct from its stockholders in a different form. * * *"

On the basis of the *National Carbide Corp.* case, we argued that the Bank, Capital Company and Merchants must be recognized as separate corporate entities and separate taxpayers, and that the acquisition of property by Merchants whether it be from Capital Company or from the Bank is a transaction which involves a tax incident upon the seller—the determination of whether the seller realized a gain or loss from the sale, that the impact of this incident cannot be avoided by the fact that the Bank as parent had dominion and control over Merchants, its subsidiary. We believe we are correct in our argument that if the sale involved in this case is construed as a sale from the Bank to Merchants, the loss suffered by the Bank, that is the difference between the selling price and the cost of the property, must be allowed as a deduction because the only ground on which the deduction could be denied is that the separate corporate identity of the Bank and of Merchants is to be disregarded which is directly contrary to the principle expressed by the Supreme Court in the *National Carbide Corp.* case.

It is respectfully submitted that for the reasons advanced in Appellant's Opening Brief and in this

Brief, The Tax Court erred in its decision in this case and its decision should be reversed.

Dated, San Francisco, California,
July 25, 1951.

George H. Koster,
Attorney for Appellant.

Bayley Kohlmeier,
Of Counsel.

No. 12882

United States
Court of Appeals
for the Ninth Circuit.

ROBERT C. NORMAN,

Appellant,

vs.

SPOKANE - PORTLAND & SEATTLE RAILWAY CO., a Corporation,

Appellee.

Transcript of Record

Appeal from the United States District Court for the District of Oregon.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

No. 12882

United States
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for the Ninth Circuit.

ROBERT C. NORMAN,

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF ATTORNEYS

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In the District Court of the United States
for the District of Oregon

No. Civ. 4090

ROBERT O. NORMAN,

Plaintiff,

vs.

SPOKANE-PORTLAND & SEATTLE RAILWAY CO., a Corporation,

Defendant.

OPINION

January 16, 1950

James Alger Fee, District Judge:

Norman, according to the agreed facts, was an employee of Gilpin Construction Company, an established private corporation engaged in contracting and construction work of a general nature, including from time to time bridge and trestle repairs for railroads, among which was the defendant Spokane-Portland & Seattle Railway Co., a common carrier of persons and of property in interstate commerce. Gilpin had not rejected the Oregon Workmen's Compensation Act, and regularly made contributions to the State Industrial Accident Commission on behalf of all its employees. The Rockton Bridge of the railroad fell into disrepair. A contract was entered into between Gilpin and the railroad for the repair thereof. During the work, Norman was seriously injured by a fall from a scaffold, which he alleges was improperly pro-

tected. For this injury, he brought action under the Federal Employers' Liability Act, upon the theory that the railroad is under a nondelegable duty to perform such work by its own employees and is therefore liable to any workman injured thereon. It was originally asked by plaintiff that the cause be tried by jury. However, the issues were finally submitted, both as to fact and law, to the Court.

There was an amended pretrial order drawn after conference, which practically reduced the case to the solution of the following question of law:

> "Where a railroad corporation engaged in interstate commerce contracts with an independent contractor for the construction, repair and maintenance of the railroad company's bridges and trestles used in interstate commerce, is it relieved from liability in damages under the Federal Employers' Liability Act for injuries to employees of the independent contractor occurring during the course of such work and caused by the independent contractor's negligent failure to provide a safe place and suitable equipment to the employees for such work?"

The cause was submitted upon the transcript of evidence taken in a similar case in the state court and the agreements contained in stipulations and in the pretrial order. It is agreed that Gilpin was in fact a truly independent contractor acting under a bona fide contract with the railroad, which was not designed or intended as a scheme or artifice to evade the provisions of the Federal Employer's

Liability Act. It is stipulated that the 1939 amendment of the Federal Employers' Liability Act has "no bearing on who are 'employees' of a railroad" under the Act. The parties have likewise agreed that the following decisions do not bear on the basic issue and may be disregarded:

> "1. Decisions as to whether the work being performed by a particular railroad employee at the time of injury was within interstate commerce so as to vest jurisdiction of the action in federal courts.
>
> "2. Decisions holding that particular factual situations by common law tests constituted the parties employer-employee rather than independent contractor-contractee.
>
> "3. Decisions under the Railroad Retirement Act, Fair Labor Standards Act and Social Act where the question presented is whether an employee is engaged in interstate commerce within the scope of the particular legislation and/or whether the employee falls within the coverage of said legislation or is otherwise within the scope of such legislation, including that of the relationship of employer-employee."

The Court therefore finds the facts as agreed in the amended pretrial order. Particularly, the Court finds as a fact that Norman was an employee of Gilpin and not an employee of defendant. The Court also finds that Norman was acting under the direction and control of Gilpin and not of defend-

ant. Gilpin had unrestrained power to direct the manner and method of doing the work and the choice of its own employees. There was actually no attempt to delegate any responsibility by defendant, but simply a normal transaction of letting repair work to an independent contractor.

The Court is of opinion that a railroad company may employ a contractor to repair bridges. The duty of the railroad company to keep such transportation facilities in reasonable repair is not non-delegable so far as employees of the independent contractor are concerned. Here the independent contractor had been in business for many years and was covered under the Workmen's Compensation Act.

Of the hundreds of cases which have been reviewed by the Court, none suggests that an employee of a true independent contractor erecting or repairing a bridge on a right of way becomes an employee of the railroad company because the duty of construction and repair of such bridges cannot be delegated. No case suggests that the employee of an independent contractor becomes an employee pro hac vice under such circumstances. In view of the history of such construction by independent contractors ever since railroads have been in existence, it is necessary to answer that the employees of the contractor do not become employees of the railroad by any legal theory. This does not derogate from the duty of the railroad to construct and repair such structures. But the duty is not to plaintiff but to its passengers. If there were a

question of control of the operation by the railroad, a possibility exists that liability of the railroad might be worked out. But the parties have entered the following stipulation, which disposes of this basis of liability as well as many others:

> "It is agreed by the parties that the Amendment to the Pretrial Order poses for this Court's determination a single question:
>
> "May a railroad delegate to an independent contractor the work of repairing, renewing and maintaining its tracks and bridges in the sense that the employees of an independent contractor who are injured in such work are not employees of the railroad within the scope and meaning of the Federal Employers' Liability Act?"

The claim of Norman for this accident was allowed by the State Industrial Accident Commission. In view of the modern policy of administrative compensation for accidents, it would seem that no distinction should be created between construction work done by this established contractor in building a railroad bridge and in building an office tower. Just because his employer happened by chance to be building a railroad bridge instead of an office building is no reason for permitting plaintiff to gamble upon the windfall of a heavy verdict or the disaster of no recovery simply because he was incidentally working on railroad bridge construction. Nor, on the other hand, is it sound public policy, if he lost in such a gamble, to permit him to fall back

into the safety net of the Workmen's Compensation Act.

The question submitted is decided in the affirmative, and the action is dismissed.

[Endorsed]: Filed February 10, 1950.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This case came on regularly for trial before the undersigned, Chief Judge of this Court. Plaintiff appeared in person and by Elton Watkins, his attorney. Defendant appeared by Hugh L. Biggs and George H. Fraser of its attorneys.

By agreement of the parties the issue of defendant's liability was segregated for separate trial by the Court sitting without a jury. Testimony and evidence were offered by each of the parties and received by the Court and the case was submitted upon the parties' oral arguments and written briefs. Concerning the issue of plaintiff's right to maintain this action against defendant, the parties, after the case had been submitted, filed the following stipulation:

"It is agreed by the parties that the Amendment to the Pretrial Order poses for this Court's determination a single question:

> May a railroad delegate to an independent contractor the work of repairing, renewing and

maintaining its tracks and bridges in the sense that the employees of an independent contractor who are injured in such work are not employees of the railroad within the scope and meaning of the Federal Employers' Liability Act?

Plaintiff's Contention

Plaintiff contends that the railroad is under a nondelegable duty to perform such work by its own employees and therefore is liable to any workman negligently injured in the performance thereof under the terms and provisions of the Federal Employers' Liability Act, irrespective of whether the railroad employed and directed the workman or an independent contractor with the railroad employed and directed such workman at the time of the accident.

Defendant's Contention

Defendant contends that a railroad has no liability under the Federal Employers' Liability Act for injuries, not occasioned by the railroad's negligence, to an employee of an independent contractor with the railroad, engaged in repairing, renewing and maintaining the railroad's bridges and tracks, and that the Federal Employers' Liability Act therefore does not prohibit the delegation of such work by a railroad to an independent contractor.

With the issue on this phase of liability being thus limited, the parties agree that the following subsidiary issues are now eliminated:

1. Whether the Gilpin Construction Company was a true independent contractor or simply an agent or servant of the SP&S.

It is stipulated in the Amendment to the Pretrial Order that Gilpin Construction Company was in fact a true independent contractor.

2. The effect of the 1939 amendment to the Federal Employers' Liability Act.

It is stipulated that this amendment was designed to broaden the concept of interstate commerce as applied to various job categories in the maintenance and operation of railroads. It has no bearing on who are "employees" of a railroad as that term is used in the Federal Employers' Liability Act.

3. Whether the contract was a scheme to evade the liabilities of the railroad under the provisions of the Federal Employers' Liability Act.

The parties agree that the contract between the defendant and Gilpin Construction Company was a bona fide contract not designed or intended as a scheme or artifice to evade the provisions of the Federal Employers' Liability Act.

The parties further agree that the following class of decisions do not bear on the basic issue as above defined and therefore may be disregarded by the Court:

1. Decisions as to whether the work being performed by a particular railroad employee at the time of injury was within interstate commerce so as to vest jurisdiction of the action in federal courts.

2. Decisions holding that particular factual situations by common law tests constituted the parties employer-employee rather than independent contractor-contractee.

3. Decisions under the Railroad Retirement Act, Fair Labor Standards Act and Social Security Act where the question presented is whether an employee is engaged in interstate commerce within the scope of the particular legislation and/or whether the employee falls within the coverage of said legislation or is otherwise within the scope of such legislation, including that of the relationship of employer-employee.

The parties reserve the right to comment orally or by memorandum on the authorities which they regard pertinent to the single issue posed by the Amendment to the Pretrial Order."

The Court having considered all matters of fact and law presented by the parties touching the issue, and now being fully advised, makes the following

Findings of Fact

I.

During all times herein material plaintiff was a resident of the State of Washington, residing with his family at Vancouver, Washington.

II.

During all times herein material defendant was and is a corporation existing by virtue of the laws of the State of Washington, and is now and at all

times herein material has been engaged as a common carrier by railroad in the transportation of persons and property within and between the States of Oregon and Washington. A part of its railroad track was on a certain trestle near Rockton, Oregon, known as "Rockton Bridge," which was owned and used by defendant in its interstate business. It was the duty of defendant to maintain its railway lines and its roadbed, tracks and bridges in a reasonably safe condition for its use in interstate commerce.

III.

Gilpin Construction Company during all of the times and dates material herein was a private corporation organized and existing under and by virtue of the laws of the State of Oregon, and was and for many years had been engaged in a general contracting business, including the construction, maintenance and repair of railroad trestles and bridges. It was and is a wholly independent corporation, in which neither the defendant nor any of its affiliates own or control any stock or interest whatsoever.

IV.

On or about the 7th day of October, 1944, Gilpin Construction Company, hereinafter referred to as "Gilpin," entered into a contract with defendant whereby for a sufficient consideration it undertook and agreed to do repair and maintenance work on defendant's trestles and bridges, including Rockton Bridge, and to furnish the equipment, tools and labor necessary to do that work.

V.

The relationship established by said contract and existing between Gilpin and the Railroad Company by virtue of said contract and the performance of the contracting parties thereunder at the time of the accident and resulting injury to plaintiff hereinafter mentioned was that of true independent contractor and contractee. Gilpin at all times material to this controversy was in fact a true independent contractor acting under a bona fide contract with defendant, which contract was not designed or intended as, and in fact was not, a scheme or an artifice to evade the provisions of the Federal Employers' Liability Act.

VI.

On and prior to January 10, 1947, plaintiff was employed by and working for Gilpin as a member of one of its construction crews which was engaged on that day in the work of repairing and enlarging Rockton Bridge. While so employed the scaffolding upon which plaintiff was standing gave way and caused him to fall to the ground, a distance of between 60 and 70 feet below the place where he had been working. As a result plaintiff sustained serious injuries to his person which incapacitated him for a long period of time and required prolonged hospital treatment and medical care.

VII.

At the time of the accident above mentioned, and for a long time prior thereto, plaintiff was and had been employed by Gilpin and was acting under the direction and control of Gilpin and not of the

defendant. Gilpin had unrestrained power to and did direct the manner and method of doing the work of repairing and maintaining the Rockton Bridge and to choose its employees. Defendant made no attempt to delegate any of its responsibility to Gilpin but by its contract with Gilpin simply entered into a normal transaction of letting necessary repair work to an independent contractor.

VIII.

Gilpin during all the times material to this controversy was engaged in a hazardous occupation, had not rejected the Workmen's Compensation Act of the State of Oregon but had made and was making contributions regularly to the Industrial Accident Commission on behalf of all of its employees, and was contributing regularly on behalf of the plaintiff in this case as one of its employees, and at all times was in good standing with the said Commission under the provisions of the Workmen's Compensation Act.

IX.

Following the accident plaintiff, as an employee of Gilpin, applied for and received medical, rehabilitation, and compensation benefits provided by the Workmen's Compensation Act of the State of Oregon from the State Industrial Accident Commission.

X.

The parties have stipulated and the Court finds that this action is brought under the Federal Employers' Liability Act, Title 28, U.S.C.A., Section

51, et seq., and plaintiff's right to maintain the action is to be determined solely in accordance with the provisions of the Federal Employers' Liability Act.

From the foregoing the Court draws the following

Conclusions of Law

I.

Plaintiff may not maintain this action against defendant under the provisions of the Federal Employers' Liability Act because he was not an employee of defendant within the meaning of said act.

II.

Plaintiff was employed by and working for Gilpin, an independent contractor, at the time of the accident and injury of which he complains herein.

III.

The contract between defendant and Gilpin, pursuant to which the work resulting in plaintiff's injury was being performed, was not designed or intended as, and in fact was not, a scheme or an artifice to evade the provisions of the Federal Employers' Liability Act.

IV.

A railroad, even though engaged in the transportation of persons and property in interstate commerce and subject to the provisions of the Federal Employers' Liability Act, may delegate to an independent contractor the work of repairing,

renewing and maintaining its tracks and bridges used in its interstate business in the sense that the employees of an independent contractor who are injured in such work are not employees of the railroad within the scope and meaning of the Federal Employers' Liability Act.

V.

Defendant has no liability under the Federal Employers' Liability Act for injuries not occasioned by its negligence to plaintiff as an employee of Gilpin, an independent contractor engaged in repairing, renewing and maintaining defendant's bridges and tracks, and the Federal Employers' Liability Act does not prohibit the delegation of such work by a railroad to an independent contractor.

VI.

Plaintiff is not entitled to recover against defendant in this action. The action therefore should be dismissed and the defendant is entitled to judgment for its costs and disbursements incurred herein.

Done and dated at Portland, Oregon, this 9th day of March, 1951.

/s/ JAMES ALGER FEE,
Chief Judge.

Receipt of Copy Acknowledged.

[Endorsed]: Filed March 9, 1951.

The United States District Court
for the District of Oregon

Civil Action No. 4090

ROBERT O. NORMAN,

Plaintiff,

vs.

SPOKANE-PORTLAND & SEATTLE RAILWAY CO., a Corporation,

Defendant.

JUDGMENT ORDER

The Court having heretofore made and entered its findings of fact and conclusions of law herein in favor of defendant and against the plaintiff, and the case now coming on for judgment in accordance with said findings and conclusions, it is, therefore

Considered, Ordered and Adjudged that plaintiff take nothing by reason of this action, that this action be and the same is hereby dismissed, and that defendant have and it is hereby granted judgment against plaintiff for defendant's costs and disbursements herein, taxed at $157.50.

Done and dated in open court this 9th day of March, 1951.

/s/ JAMES ALGER FEE,
Chief Judge.

Receipt of Copy Acknowledged.

[Endorsed]: Filed March 9, 1951.

[Title of District Court and Cause.]

NOTICE OF APPEAL

To: The Clerk of the above-entitled Court, and

To: Spokane-Portland & Seattle Railway Co., a corporation, and

To: Hugh L. Biggs, George H. Fraser, and Hart, Spencer, McCulloch, Rockwood & Davies, Attorneys at Law for Appellee-Defendant.

You and each of you will please take notice that Robert O. Norman, the plaintiff above named, does hereby appeal to the United States Circuit Court of Appeals for the Ninth Circuit thereof from the Judgment Order made and entered on March 9, 1951, wherein the Court considered, ordered and adjudged that plaintiff take nothing by reason of this action and that the said action be, and the same is dismissed, and that defendant have judgment against plaintiff for defendant's costs.

Dated at Portland, Oregon, this 15th day of March, 1951.

/s/ ELTON WATKINS,
Attorney for Plaintiff.

Receipt of Copy Acknowledged.

[Endorsed]: Filed March 15, 1951.

CLERK'S CERTIFICATE

United States of America,
District of Oregon—ss.

I, Lowell Mundorff, Clerk of the United States District Court for the District of Oregon, do hereby certify that the foregoing documents consisting of opinion of the court, findings of fact and conclusions of law, judgment, notice of appeal, bond on appeal, designation of record, and transcript of docket entries, constitute the record on appeal from a judgment of said court in a cause therein numbered Civil 4090 in which Robert C. Norman is plaintiff and appellant, and the Spokane-Portland & Seattle Railway Co., a corporation, is defendant and appellee; that the said record has been prepared by me in accordance with the designation of contents of record on appeal filed by the appellant, and in accordance with the rules of this court.

I further certify that the cost of filing the notice of appeal, $5.00, has been paid by the appellant.

In Testimony Whereof I have hereunto set my hand and affixed the seal of said court in Portland, in said District, this 21st day of March, 1951.

[Seal] LOWELL MUNDORFF,
Clerk.

By /s/ F. L. BUCK,
Chief Deputy.

[Endorsed]: No. 12882. United States Court of Appeals for the Ninth Circuit. Robert C. Norman, Appellant, vs. Spokane-Portland & Seattle Railway Co., a corporation, Appellee. Transcript of Record. Appeal from the United States District Court for the District of Oregon.

Filed March 23, 1951.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals
for the Ninth Circuit

No. 12882

ROBERT O. NORMAN,

Appellant,

vs.

SPOKANE-PORTLAND & SEATTLE RAILWAY CO., a Corporation,

Appellee.

STATEMENT OF POINTS ON WHICH APPELLANT INTENDS TO RELY ON APPEAL AND DESIGNATION OF RECORD

Appellant herein, pursuant to Rule 19(6) of the Federal Rules of Civil Procedure, hereby designates the portions of the record to be contained on the record on appeal in this cause and the points on which appellant intends to rely on appeal.

1. Re — Designation of Record: Findings of Fact and Conclusions of Law and Judgment Order. Notice of Appeal and Clerk's Certificate.

2. Statement of points on which appellant intends to rely on appeal, to wit: The Court erred in entering the Judgment Order which is not supported by the Findings, that is to say:

(a) The District Court erred in holding that the duty imposed upon appellee to maintain its railway lines and its road bed, tracks and bridges in a reasonably safe condition for its use in interstate commerce was a delegable duty.

(b) The District Court erred in holding that appellant may not maintain this action against appellee under the provisions of the Federal Employers' Liability Act because he was not an employee of appellee within the meaning of said Act, but an employee of an independent contractor.

(c) The District Court erred in holding that appellee, even though engaged in transportation of persons and property in interstate commerce and subject to the provisions of the Federal Employers' Liability Act, may delegate to an independent contractor the work of repairing, renewing and maintaining its tracks and bridges used in its interstate business in the sense that the employees of an independent contractor who are injured in such work are not employees of the railroad within the scope and meaning of the Federal Employers' Liability Act.

(d) The District Court erred in entering its Judgment Order dismissing this action as said Judgment Order is not supported by the Federal Employers' Liability Act and the interpretations by the courts of said Act.

Dated at Portland, Oregon, this 29th day of March, 1951.

/s/ ELTON WATKINS,
Attorney for Appellant.

Receipt of Copy Acknowledged.

[Endorsed]: Filed March 30, 1950.

No. 12882

United States
COURT OF APPEALS
for the Ninth Circuit

ROBERT O. NORMAN,

Appellant-Plaintiff,

v.

SPOKANE-PORTLAND & SEATTLE RAILWAY CO., a corporation,

Appellee-Defendant.

Appeal from the United States District Court for the District of Oregon

HON. JAMES ALGER FEE, *Judge.*

APPELLANT'S BRIEF

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Attorneys for Appellee.

STEVENS-NESS LAW PUB. CO., PORTLAND 4-51

SUBJECT INDEX

AUTHORITIES

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No. 12882

United States
COURT OF APPEALS
for the Ninth Circuit

ROBERT O. NORMAN,

Appellant-Plaintiff,

v.

SPOKANE-PORTLAND & SEATTLE RAILWAY CO., a corporation,

Appellee-Defendant.

Appeal from the United States District Court for the District of Oregon

HON. JAMES ALGER FEE, *Judge.*

APPELLANT'S BRIEF

JURISDICTION

This is an appeal from a judgment order by Hon. James Alger Fee, Judge, dated and entered March 9th, 1951, dismissing appellant's action for damages in the sum of $275,000.00 for injuries sustained by reason of

the negligence of the appellee. From this judgment order appellant filed notice of appeal on March 15th, 1951.

The jurisdiction of the District Court of the United States for the District of Oregon was invoked under the Federal Employers' Liability Act, 35 Stat. 65 and 53 Stat. 1404.

STATEMENT OF CASE

This action was instituted by appellant against appellee under the Federal Employers' Liability Act, for injuries sustained by him on January 10, 1947, while engaged in the work of repairing Rockton Bridge, a trestle of appellee, which bridge had fallen into disrepair; and while so employed as a carpenter the scaffolding upon which appellant was standing gave way and caused him to fall to the ground, a distance of 60 feet below, resulting in very serious injuries to appellant. During this repair work the appellee retained control and the constant use of said bridge and tracks and the repair crew were subject to appellee's train orders,—the train order containing line up of trains dispatched over Rockton trestle for January 10th, 1947, is shown by Exhibit 4.

The appellee was chartered by the State of Washington, as a common carrier engaged in interstate commerce by railroad in the transportation of persons and property within and between the states of Oregon and Washington. A part of its railroad track was on a certain trestle near Rockton, Oregon, known as Rockton

Bridge, which was owned and used by appellee in its interstate business.

The charter issued by the State of Washington to the appellee and the Findings of Fact II, inter alia, obligated appellee to maintain and keep in repair its railway lines, roadbed, tracks and bridges (R. 11-12).

Gilpin Construction Company was a private industrial corporation created by the statutes of Oregon, and was for years engaged in a general contracting business. In 1944 this corporation and the appellee entered into a contract by which the Gilpin Construction Company agreed to do repair and maintenance work on appellee's trestles and bridges including Rockton Bridge. Following is a copy of the contract between appellee and the Independent Contractor under which the work was done. Received in evidence and marked Defendant's Exhibit No. 7:

"DOCUMENT NO. SP&S 7208

THE GILPIN CONSTRUCTION COMPANY
GENERAL CONTRACTORS

4850 N. W. Front Avenue
Box 3860
Portland, Oregon

October 7, 1944.

Spokane, Portland and Seattle Railway Co.,
901 NW Hoyt Street,
Portland 9, Oregon

Attention: Mr. A. J. Witchell, Chief Engineer

Gentlemen:

As per our conversation of October 6th, we submit a proposal for furnishing labor and necessary

equipment to do repair and maintenance work on your trestles and bridges, as outlined in our talk, on a basis of cost plus ten (10%) percent.

Our costs are to include all expenses to us made up as follows:

All payrolls in connection with this work, all insurance on men, getting equipment and tools to and from the jobs and rentals on any equipment which is rented from others by us. On any equipment which is owned by us, the ten percent will not be added and all our rental prices are to comply with the OPA rental rates.

All saws, peavies and other miscellaneous small tools will be billed out to you at the start of the work and a credit will be issued at the finish of the job on the value of the tools according to their condition when returned.

We propose to have one timekeeper to take care of all the crews and his time will be distributed to the different jobs.

Our crews will be controlled by a foreman who will be directly in charge of the work. This foreman will receive \$2.00 more per day than the pilemen, whose scale is \$1.49 per hour.

On work where our boys have to live away from home, we will have to work them ten hours per day in order to get them to leave home and this extra time helps pay their board. It is also understood that our men will work on Saturdays at time and one-half pay.

Yours truly,
THE GILPIN CONSTRUCTION COMPANY
/s/ Otto Herman
Otto Herman, Vice President.

SPOKANE, PORTLAND AND SEATTLE RAILWAY CO.
ACCEPTED: By /s/ A. J. Witchell
Chief Engineer
APPROVED: By /s/ T. F. Dixon
Vice Pres & General Manager"

Appellant was a member of the crew of Gilpin Construction Company and on its payroll, but brought this action, not against the Gilpin Construction Company, but the Spokane-Portland & Seattle Railway Co., upon the theory that the railroad was under a non-delegable duty to perform such work by its own employees and was therefore liable to any workman performing that same service and injured while so engaged.

During the proceedings the parties concluded that the right to maintain such an action was practically reduced to the following question of law:

> "Where a railroad corporation engaged in interstate commerce contracts with an independent contractor for the construction, repair and maintenance of the railroad company's bridges and trestles used in interstate commerce, is it relieved from liability in damages under the Federal Employers' Liability Act for injuries to employees of the independent contractor occurring during the course of such work and caused by the independent contractor's negligent failure to provide a safe place and suitable equipment to the employees for such work?" (R. 4).

In time the question submitted was decided in the affirmative, and the Court dismissed the action. Hence this appeal.

AUTHORITIES

See Index

The authorities on the question involved in this appeal are listed in alphabetical order in the index and will not be duplicated at this point, but will be referred to in the argument in the order of its logical development.

SPECIFICATIONS OF ERROR

(R. 21-22)

1. The Court erred in entering the Judgment Order which is not supported by the Findings.

2. The Court erred in holding that the duty imposed upon appellee to maintain its railway lines and its road bed, tracks and bridges in a reasonably safe condition for its use in interstate commerce was a delegable duty.

3. The Court erred in holding that appellant may not maintain this action against appellee under the provisions of the Federal Employers' Liability Act because he was not an employee of appellee within the meaning of said Act, but an employee of an independent contractor.

4. The Court erred in holding that appellee, even though engaged in transportation of persons and property in interstate commerce and subject to the provisions of the Federal Employers' Liability Act, may delegate to an independent contractor the work of repairing, renewing and maintaining its tracks and bridges used in its interstate business in the sense that the employees of an independent contractor who are injured in such work are not employees of the railroad within the scope and meaning of the Federal Employers' Liability Act.

5. The Court erred in entering its Judgment Order dismissing this action as said Judgment Order is not supported by the Federal Employers' Liability Act and the interpretations by the courts of said Act.

ARGUMENT

This appeal presents one question of law: That question is whether a common carrier engaged in interstate commerce can delegate to another its duties to maintain and keep in repair its roadbed, tracks and trestles, and thereby escape all liability for injuries to workmen sustained by them while engaged in the repairs of a trestle of appellee, due to the negligence of the contractor in charge of the crew in that a reasonably safe place in which to work was not provided the men repairing the trestle.

There is no controversy as to the facts involved in the solution of this question.

If the answer to the question of law involved is in the affirmative, then appellant has no claim against appellee; if in the negative, then the case must go back to determine the damages.

All specifications of error may be considered together under the question as to whether the Court made error in holding that the duty imposed upon appellee by its franchise to keep in repair its roadbed, tracks, and trestles could be legally delegated to an independent contractor, and the appellee held blameless for any negligence in said repairs resulting in injury to appellant engaged in said work and the appellant denied recourse against appellee for damages.

Appellant has always assumed that it was elementary that a Railroad could not delegate away any

of its essential functions as a Railroad to an independent contractor, or any body, or at all, and thus escape the obligations of the Federal Employers' Liability Act.

Appellant contends that the maintenance of appellee's track and trestles was essential to the exercise of its franchise rights and in making these repairs it was the nondelegable duty of appellee to provide the men who make the repairs a reasonably safe place in which to work and reasonably safe tools with which to work. This is the duty which appellee undertook to delegate to Gilpin Construction Company and the work appellant was doing when he fell sixty feet to his severe and permanent injury. Work in fact that appellee was unable to devest itself of control and was so interwoven with the work of exercising its franchise rights that it was unable to delegate to another. Furthermore the power of control lodged in appellee by its charter could not in law be delegated, nor could appellee in law fail to exercise that power of control, or fail to perform that duty itself.

Appellee was at Rockton bridge by virtue of a franchise issued to it by the State of Washington. Everything stemmed from that document. Nothing could be done by anybody but by virtue of that document. The duty to build the bridge, to repair it, to maintain it and to use it was vouchsafed by that document and imposed upon and exacted of appellee and of appellee only. The independent contractor could not have obtained or used that document, nor could appellant. Nobody but appellee could use it; nobody but appellee could do the

things required therein. The independent contractor could not by its own boot-straps lift itself into the position of a grantee of a franchise with the right to perform the duty of maintaining and keeping in repair the said bridge. Nor could said independent contractor put on the boots of appellee, nor could appellee itself lift the independent contractor by the contractor's boot-straps to the position and the plane only occupied by appellee.

The state in granting the charter clothed appellee with certain sovereign powers. Powers that it would not grant to an independent contractor. Powers that appellee could not escape or throw off even by bankruptcy. Powers that could not be obtained except by a grant from the state. Powers that could not even be granted by the state itself to a private corporation like Gilpin Construction Company. Powers that appellee could not even lease to another common carrier clothed with similar powers with a charter from the same state. It would seem that simply to state the premise would furnish the answer to the proposition in case at bar.

Whoever uses the rights contained in the charter uses the charter; whoever performs the duties or does the work contained in the franchise is doing that required of the grantee of the charter, and whoever does a thing through another, that is required of him, does it himself.

The question presented here is novel, in so far as the Supreme Court of the United States is concerned,—a case exactly like case at bar has not been found. The Supreme Court has refused to grant certiorari in cases

in which the question of delegation occurred. Likewise the Supreme Court has passed on questions akin to but not decisive of the right to delegate. In those cases wherein the Supreme Court approximated the question, the facts are at such variance with those in case at bar that in the search for the answer we must resort to and rely upon cases in lesser courts and the parity of reasoning in our examination of cases analogous to but not exactly like case at bar.

The Supreme Court has dealt with questions that go almost to the very heart of "delegation of duty" as in case at bar; but always under other descriptions and legal definitions or terms,—such as: power of control, occupation of workman, whose work was being done, whose duty involved, pro hac vice, who received services, master and servant, vice-principal, loaned servant, agency, etc.

It is the contention of appellant that the railroad could not delegate this duty to anybody; that its duty to comply with the provisions of its charter was an agreement with the State and was a personal, positive, non-assignable responsibility; that in doing what it did do, it did not devest itself of the legal responsibility imposed upon it by its franchise, it simply took a chance and flirted with the consequences, but it did not escape the burdens flowing from its breach of duty; and that the independent contractor it placed in charge of said repairs was its agent or vice-principal.

At the very threshold we propose to demonstrate that throughout the decisions cited, whether ordinary

master and servant problems, or those under the Federal Employers' Liability Act, or questions arising under the Jones Act, involving seamen or stevedores, or those involving independent contractor—one and all—there runs a thread of unity, or as one authority observed—"a common core", by which unerringly the true and correct relationship of master and servant can be determined, and by which criterion the correct solution can be obtained as to whose servant is the particular workman. The answer does not depend on who hired, who paid, or who could discharge the servant. The answer is obtained by establishing: Whose is the work, whose is the "power of control", whose is the legal duty to see that the premises whereat, or the tool with which, the work was done were reasonably safe for the workman, or whose was the non-assignable legal responsibility to discharge the duty in question, or who rendered and who received the services. Mere relationship of employer and employee is not the criterion, the occupation of the workman at the time of the injury may determine the question. In fact, there may be no contractual relation —a member of the public is protected by reason of the franchise and the statute.

In the beginning and before we delve into the cases, appellant desires to submit to the Court that a railway corporation receiving a franchise from the state, with the high and peculiar privileges attaching to a corporation incorporated to discharge a public duty as well as to subserve a private benefit, cannot shift upon others the duty and responsibility of a personal exercise of the corporate powers granted. It may lease the road, when

constructed, to another corporation, whose road, with its own will make a continuous line. It may employ others to do certain repairs, maintenance and the like; but it cannot avoid responsibility by simply permitting another party to perform and execute the functions imposed upon it in its charter. We submit that the Court will find a clear line of distinction where there seems to be confusion and the line of distinction can be determined by ascertaining wherein there is an element of duty and wherein the element of duty is omitted. In the former the railroad cannot delegate the duty. In the latter there is some question for even in those cases other principles of law might prohibit the delegation. In case at bar, the element of duty stems from both the franchise and the Federal statute.

The Test

At this point let us state that delegation is abdication. And that in all cited cases regardless of the several doctrines under which they are classed the point to be gathered is that "power of control" is the basis of holding the carrier. And what was the "occupation" of the workman—"whose work was being done"—is the basis of the workman's protection. These are the Tests.

So, in a paragraph, let us state succinctly the case at bar: The duties and obligations resting on appellee stem from the franchise granted to it by the State and from the Federal Employers' Liability Act enacted by the Congress; and the liabilities chargeable to appellee spring from the infraction by it of the franchise and the

statute,—under the doctrine of power of control, which duties were personal, positive and non-delegable; and if appellant sustained injuries while engaged in duties in the furtherance of interstate commerce by reason of his "occupation", the questions for determination are questions of fact for a jury under the statute.

Roberts Federal Liability of Carriers, 2d Edition, Vol. 2, page 1475, says:

> "The general rule is that if a railroad of a common carrier is a highway of interstate commerce, its roadbed, tracks, bridges, tunnels and culverts are instrumentalities of interstate commerce, so that employees that take part in the maintenance and repair of them are engaged in interstate commerce within the meaning of the Federal Employers' Liability Act. Track laborers and section men are included in this class; so also are carpenters and bridge workers. The status of such men is not affected by the fact that these instrumentalities are also used in intrastate commerce, or that the line of the carrier lies wholly within the limits of a single state."

In Choctaw, O. & W. Railroad v. Wilker, supra, 16 Okla. 384, 84 Pac. 1086, 3 L.R.A. (N.S.) 595, the Court said:

> "1. We take the rule to be elementary that, where the statute imposes upon a railroad corporation a certain duty, it cannot escape liability for a failure to perform that duty, or a damage occasioned thereby by delegating that authority to an independent contractor," (citing 1 Thompson on Neg., p. 278).
>
> "2. We have carefully examined the cases submitted by counsel for plaintiff in error (the Railroad) to sustain their contention, but we think in

> those cases there is a decided difference in the facts from those in case at bar. In all these cases, we think without exception, the element of a public duty is omitted."
>
> "3. We do not think that any of these cases would sustain the contention that where a railroad company, under the law, was charged with the duty to the public, and the injury complained of resulted from a failure to properly discharge that duty, their liability could be avoided by showing that the work was done under an independent contract."

This case revolved around the following situation: The railroad company charged with the duty of keeping a highway in a reasonably safe condition for travel at the point where the highway intersects the right of way, and further required, when making alterations by means of which the highway may be obstructed, to provide and keep in good order suitable temporary ways to enable travelers to avoid or pass such obstructions: cannot, where a party is injured in consequence of its failure to discharge these duties, escape liability by showing that the work was done by other persons under an independent contract.

Delegation of Duty Doctrine

The duty required of the master concerning the servant is expressed succinctly in the following cases:

Panama R. Co. v. Minnix, C. C. A. Canal Zone, 282 F. 47, holds:

> "The duty of making reasonably safe the place where an employee works and the duty of warning him of unsafe conditions, are duties of the master,

who cannot avoid responsibility for their non-performance by delegating them to a fellow servant."

Chicago Junction R. Co. v. King, Ill., 169 F. 372, 94 C. C. A. 652, affirmed, 32 S. Ct. 79, 222 U.S. 222, 56 L. Ed. 173, holds:

"The duty of seeing that no cars used in interstate commerce are hauled by a railroad company unless equipped with the required safety appliances is imposed on the company, and cannot be evaded by delegating the same to the conductor of a train or other employee whose action in that respect is that of the company."

Wilczynski v. Pennsylvania R. Co., 100 A. 226, 90 N. J. Law 178, holds:

"Where method of doing work has direct bearing on safety of servant, the duty is on the master to use reasonable care to provide a safe method; and he cannot escape liability by intrusting its performance to others, and in action for death of servant of railroad when a steel beam being loaded on a lighter fell upon him while he was working on the boat at his foreman's orders, it was immaterial what relation existed between the boat owner and the railroad."

Roberg v. Houston & T. C. R. Co., Tex. Civ. App., 220 S.W. 790, holds:

"A railroad furnishing a wrecking crew with chains of various and ample strength is not liable for the death of an experienced foreman from breaking of a chain of insufficient strength which he selected."

Blessing v. Camas Prairie R. Co., 100 P. 2d 416, 3 Wash. 2d 266, holds:

> "A railroad was under a nondelegable duty to provide a locomotive fireman with a safe place in which to work, and owed the fireman a continuing duty of exercising reasonable care in keeping the place safe."

Porter v. Terminal R. Ass'n of St. Louis, Ill. App., 65 N.E. 2d 31, 327 Ill. App. 645, holds:

> "A master owes continuous, nondelegable and affirmative duty to furnish servant reasonably safe working place, machinery, and instrumentalities, though servant is sent on another's premises to do his work."

Re: non-delegable duties, 39 C.J. 285, Section 412, says:

> "Certain primary or absolute duties are imposed by law upon the master, such as the provision of a safe place to work, the furnishing of safe and suitable appliances and instrumentalities for work, the employment of a sufficient number of servants, the selection of competent servants, and the establishment of proper rules and methods of work. The performance of such primary or absolute duties cannot be so delegated by the master as to relieve him from liability for the consequences of a failure to discharge them, but the negligence with regard thereto of one to whom their performance is intrusted by the master is regarded as that of the master for which he is responsible, even though they are intrusted to a person of approved skill and fitness."

Citing:

Brady v. Chicago Ry. Co., 114 Fed. 100;

Camenzind v. Freeland Furniture Co., 89 Ore. 158;

California Navigation Co., 110 Fed. 670:

Central Trust Co. v. Wabath Ry. Co., 34 Fed. 616;

Howard v. Denver Ry. Co., 26 Fed. 837.

39 C.J., p. 322, Sec. 445 on Delegation of Duty, says:

"The duty of the master is a positive obligation resting upon him, and he is liable for the negligent performance of such duty whether he undertakes its performance personally or delegates it to another. So the duty of the master in respect to reasonably safe instrumentalities and place of work is a continuing one, the duty of inspection resting upon the employer in consequence thereof cannot be delegated so as to relieve him from the consequences of a failure to inspect or of an inadequate inspection, (citing numerous cases from U. S. Supreme Court, U. S. Circuit Courts and various state courts)."

In 23 A.L.R., p. 1003, in an extensive note upon non-delegable duty, the following occurs:

"It is well settled that the duties to which the grantee of a franchise or other special privilege, authorizing certain work, becomes subject, either expressly or by implication, are absolute in such a sense that he cannot, by employing an independent contractor to execute the work, devest himself of his liability in respect of their proper performance."

The rule is stated in Restatement of Torts, Sec. 428, as follows:

"An individual or a corporation carrying on an activity which can be lawfully carried on only under a franchise granted by public authority and which involves an unreasonable risk of harm to others, is subject to liability for bodily harm caused to such others by the negligence of a contractor employed

to do work in carrying on the activity, (Venuto v. Robinson, 118 F. 2d 679, 3rd Cir. N.J.; Kemp v. Creston Transfer Co., 70 F. Supp. 521)."

Where work to be performed by an independent contractor is dangerous, as in case at bar, or the obligation rests on the employer to keep the subject of the work in safe condition as in case at bar, the general rule exempting the employer from liability for personal injuries to an employee of the contractor does not apply, and it is the settled law that an owner has the non-delegable duty to furnish workmen a safe place in which to work and safe material with which to work, so that appellant is not precluded from recovering from appellee merely or solely because appellant was not the immediate employee of appellee, nor the fact that Gilpin Construction Company was an independent contractor of itself does not preclude the appellant from recovering from the appellee in this action.

Fisher v. Portland Railway L. & P. Co., 74 Ore. 229;

Warner v. Synnes, et al., 114 Ore. 451.

In Vickers v. K. & W. V. R. Co., supra, the plaintiff and others were employed by defendant as laborers in building a railroad which was not completed but some trains were being run while the work of construction was still going on. The plaintiff by arrangement of defendant was carried to and from his place of employment along the road and to and from his boarding place on the work train of defendant. Along the track by permission of defendant a derrick used in loading stone

had been erected by an independent contractor. On one trip, guy ropes supporting the derrick sagged over the track and dragged the plaintiff off between the car and the engine. The contractor was negligent in causing the injury to plaintiff. The defendant relies on the proposition that the negligence being primarily that of the independent contractor its whole duty to the plaintiff to provide him with a reasonably safe place to work was discharged when it employed a competent independent contractor and permitted him to suspend the guy ropes in question over its track. The Court said: "We are brought face to face with the question, What is the duty of a railroad company under the circumstances of this case?" The syllabus of the case is borne out by the text and is as follows:

> "1. The general rule, subject to exceptions, is that, where one has contracted with a competent and fit person exercising an independent employment to do a piece of work, not in itself unlawful, or of such a nature that it is likely to become a nuisance, or to subject third persons to unusual danger, according to the contractor's own methods, and without being subject to control, except as to results of his work, will not be answerable for the wrongs of such contractor, his subcontractors, or his servants, committed in the prosecution of such work.
>
> "2. But, with respect to railroads, the nonassignable duty of the master to provide its servant a reasonably safe place to work extends to the entire track over which the servant is required to pass in the discharge of his duties; and this is a positive duty, which, although intrusted to an independent contractor, will not absolve it from liability for the nonperformance thereof.

"3. Where one is employed by a railroad company as an independent contractor, to do certain work in the construction of its roadbed, in all matters incident to the use of its tracks permitted by such company the contractor and his workmen represent the will of the company, and its responsibility remains.

"4. Although a railroad company employs a competent independent contractor to do certain work, and, in the execution of his contract, permits him to suspend over its tracks guy ropes, the effect of such contract, with respect to such ropes, is simply to delegate to such independent contractor performance of a nonassignable duty of such company to maintain a reasonably safe place for its servants to work, rendering it liable for his negligent performance thereof.

"5. Where a railroad company has permitted the erection of guy ropes over its tracks, by an independent contractor employed to perform a part of the work of constructing its roadbed, it will nevertheless be rendered liable for any negligence on the part of such independent contractor in relation to such guy ropes, whether competent or not, although it may not have had actual notice of such negligence in time to have avoided injury to its servant resulting therefrom. In such cases the law requires inspection and tests adequate to avoid dangers.

"6. Where a railroad company intrusts performance of any of its positive duties to its servants to an independent contractor, his relationship to the defendant becomes that of vice principal, and his negligent performance of those duties becomes notice to his principal, rendering it liable for injuries to its servants, resulting therefrom."

Pedersen v. D. L. & W. R. Co., supra, deals with the repair of tracks and bridges and the nature of the duty resting upon the carrier. The facts involved an employee

killed while carrying a sack of bolts or rivets to be used in repairing a bridge. The ruling of the lower court required a determination by the Supreme Court of the United States as to whether or not the work involved interstate commerce within the meaning of the Federal Employers' Liability Act. The point made was that the plaintiff was not at the time of his injury engage in removing the old girder and inserting the new one, but was merely carrying to the place where that work was to be done some of the materials to be used therein. The court said that there was no merit to that contention. That the repair of the bridge was a part of the work, or in other words, it was a minor task which was essentially a part of the larger one. In passing upon the question the Supreme Court said:

> "Tracks and bridges are as indispensable to interstate commerce by railroad as are engines and cars; and sound economic reasons unite with settled rules of law in demanding that all of these instrumentalities be kept in repair. The security, expedition, and efficiency of the commerce depends in large measure upon this being done. Indeed, the statute now before us proceeds upon the theory that the carrier is charged with the duty of exercising appropriate care to prevent or correct 'any defect or insufficiency . . . in its cars, engines, appliances, machinery, track, roadbed, works, boats, wharves, or other equipment' used in interstate commerce. But independently of the statute, we are of opinion that the work of keeping such instrumentalities in a proper state of repair while thus used is so closely related to such commerce as to be in practice and in legal contemplation a part of it. The contention to the contrary proceeds upon the assumption that interstate commerce by railroad can be separated

> into its several elements, and the nature of each determined regardless of its relation to others or to the business as a whole. But this is an erroneous assumption. The true test always is: Is the work in question a part of the interstate commerce in which the carrier is engaged?" (citing cases)

So, therefore, the trestle in question being indispensable to interstate commerce by the appellee and by law must be kept in repair which obligation rested upon the appellee or as the Court said: "Indeed the statute now before us proceeds upon the theory that the carrier is charged with the duty of exercising appropriate care to prevent or correct 'any defect or insufficiency . . . in its . . . track, roadbed . . . or other equipment' "— and that being true we submit that the duty to perform that work is a personal one and the appellee is liable for injuries sustained by appellant and for appellee to contend otherwise is a pure quibble.

The warranty of a safe place for workmen to perform their services covers all workmen which term includes not only every servant directly employed by the railroad to keep in safe repair its roadbed, railway lines and bridges, but also those men indirectly employed who perform the same service usually performed by members of the regular railway construction crew. And the reason is that these services are of direct necessity and benefit to the railroad and its owner and imposed by franchise upon the railroad.

Appellant was performing a duty essential to interstate commerce, a duty the State of Washington had imposed on the appellee. Its liability to its employees

does not rest upon its contract of employment, but of repairing and keeping in safe condition the railroad's instrumentalities of interstate commerce with its consent. It responsibility to perform this duty cannot be contracted away.

Nor can the appellee slough off its liability to those who do the railroad's work by bringing an intermediary contracting employer between itself and those workers.

Appellant is entitled to this protection regardless of the fact that he was employed immediately by another than the common carrier. For these purposes he is in short a railroad carpenter, because he is doing a railroad carpenter's work and incurring the railroad carpenter's hazard. Moreover, to make the policy effective the grantee of the franchise is brought within the liability which is peculiar to the employment relation to the extent that and because every one involved undertakes the service of the railroad.

For convenience, perhaps, the railroad may be at liberty to conduct its business by securing the advantages of specialization in labor and skill brought about by modern divisions of labor. However, it is not at liberty by doing this to discard its responsibilities imposed by franchise, one of which is the duty to maintain its railway lines and roadbed, tracks and bridges in a reasonably safe condition for its use in interstate commerce and to furnish the workmen a reasonably safe place in which to do this work. It is peculiarly and exclusively the obligation of the railroad and it is one it cannot delegate.

True that these non-delegable duties are sometimes placed in the hands of others, and to all intents and purposes things move along as smoothly and many times perhaps more smoothly than if actually performed and executed by the railroad; but, in every case, the ultimate power,—"power of control", remains in the railroad, because it did not have the legal right to relinquish any power or duty of its franchise; and, in every such case, when put to the test it has always been found that the railroad not only could not but did not lose "the power of control". To let another one use it, is fraught with danger and when loaned or let to another for the convenience, benefit or what-not of the railroad, said railroad must bear the burdens, for the holder of the franchise always and exclusively retains the ultimate "power of control", which it cannot abdicate.

Power of Control Doctrine

Our next case, A. C. L. v. Tredway, gives the answer on the theory of who possessed in law the ultimate "Power of Control"; not who exercised it. Tredway was a signalman, hired, paid and subject to discharge by Southern Railway Company, a common carrier; by contractual arrangements between Atlantic Coast Line and Southern Railway, Tredway was hired to care for signal system over which A. C. L. had jurisdiction and power of control; Tredway was killed by negligence of A. C. L. railroad. Under the rule laid down in this case the answer is that appellee in case at bar is liable because of the "Power of Control" doctrine.

In this case, A. C. L. Railway v. Tredway, the facts briefly were that A. C. L. Railway was senior in location at Emporia. Southern Railway wanted to cross A.C.L. and as a condition for that privilege, A. C. L. exacted of Southern Railway the cost of maintenance of the signal system, hiring and paying the employees, with the power to discharge them. One of the signalmen was killed by A. C. L. This action was instituted and A. C. L. claimed Tredway was not its employee and Southern Railway to blame. Court held against A. C. L. on "Power of Control" theory holding that:

> 1. A railway company cannot assign to an independent contractor the duty of maintaining signal lights along its railway tracks, so as to relieve it from liability for injury to a servant while in the performance of such duty.
>
> 2. The relationship of master and servant is determined by the question whether or not one discharges the duties of a servant to the other, which service is accepted by the latter, or is of a character with respect to which the duty of the one sought to be charged as master is non-assignable.
>
> 3. A railroad is the employer of a man injured while rendering services to it in and about the signaling of trains, although, by virtue of contract between the railway and another, he is employed and paid by the other which also has the right to discharge him.
>
> 4. Where the duty is non-assignable, the master cannot escape the duty resting upon him by relinquishment of control of the servant, or by otherwise making it impossible for himself to perform the duty.
>
> 5. The ultimate power of control was possessed by the A.C.L. through its contract with Southern

> Ry. which company was merely the agent of the A. C. L. to exercise the immediate control of Tredway, with the ultimate power of control remaining vested in the A. C. L.
>
> 6. The A. C. L. had the power of control in question originally. It need not have parted with it. If it did, partly or wholly, it could not thereby devest itself of the legal responsibility it was under to exercise such control.

Judgment for plaintiff against the defendant was affirmed.

Certiorari was sought by the railroad in this case, but was denied by the U. S. Supreme Court on January 14, 1918, 245 U.S. 670, 62 L. Ed. 540, 38 Sup. Ct. Rep. 191.

In the Tredway case, the question was whose duty was it to furnish Tredway with a safe place in which to do his work and to determine the answer to that question, it was necessary to ascertain who had the right to control, not who did control. The right rested with the Atlantic Coast Line Ry. On its shoulders was the duty and the responsibility to see that Tredway had a safe place in which to work. In contracting with the Southern Railway obligating it to hire men to do the work and to pay them and to discharge them if it so desired did not in the slightest degree lessen the duty imposed upon the Atlantic Coast Line to see that its responsibilities were properly performed.

The test is not whether the contract reserves to the railroad the power of control over the employee on the work at the time the workman was injured; the test is

whether the duty to keep in repair its tracks and trestles imposed by the franchise upon the railroad is one that the railroad can assign to any one and absolve itself from any liability flowing from the failure to furnish a safe place in which to work to those making the repairs.

This exercise of right of control or power of control does not stem from the contract between the railroad and the contractor but from the franchise by the state to the railroad. The franchise itself clothes the railroad with the power of control which includes exercise of control. These powers are granted by the state and without the consent of the state the railroad cannot abdicate these rights to any one. So in the repair of Rockton Bridge it was the work of the Spokane-Portland & Seattle Railway Co. and it alone had the power of control and the work was its work and it must bear the responsibility for appellant's injuries.

As said before during the time the repairs were being made on the Rockton Bridge, there was no cessation of interstate traffic; the trains of the appellee continued to run, and train orders were issued to all including the foreman of the crew of which appellant was a member, i.e., the appellee at all times had complete and absolute control as a proprietor of the premises and at any time it could stop or continue and determine the way in which the work should be done—none of these could it abdicate. Gilpin Construction Co. could only do this repairing as the agent or vice principal of appellee, (18 R.C.L. 784).

Vice-Principal Doctrine

We now pass to that phase of the law dealing with the master's obligation to the servant with respect to safe places in which to work wherein the master does not act directly, but attempts to perform his duty through another. A master's duty to furnish, when necessary, a reasonably safe structure or scaffold on which to work is a personal, positive, absolute obligation, and he cannot, by delegating it to another, absolve himself from liability for its non-performance. The master is answerable for the negligent performance of such duty, whether he undertakes it personally or through an agent, and this is true although the agent may, as to other matters, be merely a fellow servant. Any person who performs this duty for the master is the vice-principal of the master.

Sullivan v. Hannibal & St. Joseph R. Co., 107 Mo. 66, 28 A.S.R. 388;

C. & A. Ry. Co. v. Maroney, 170 Ill. 520, 62 A.S.R. 396;

Gann v. Railroad Co., 101 Tenn. 380, 70 A.S.R. 687;

Ell v. Nor. Pac. Ry., 1 N.D. 336, 26 A.S.R. 621.

The case of Sullivan v. Hannibal Railroad, supra, was an action for damages for injuries resulting to plaintiff in consequence of the falling of a portion of a scaffold or staging upon which plaintiff and other carpenters, under Prather, their foreman and the agent of the defendant, were engaged in removing an ice-house of the latter, which was to be erected at another place.

The foreman, Prather, stood in the relationship, not of a fellow servant of the plaintiff, but as the vice-principal, the alter ego of the defendant railroad company and the Court held that such person having charge of laborers engaged in the removal of a railroad company's building is a vice-principal of the company, and when such person as in this case orders a laborer to use a defective staging and injury results to the latter from such use, the company is liable therefor, and the Court said that although the laborer injured knew, to a certain extent, of the defect in such staging, but did not know the danger he was subjected by reason of the defect, while the foreman did know it, or could have known it if he had done his duty, the company will be liable for the injury resulting from the fall of such defective staging.

A foreman of a gang of railway workmen engaged in repairing trestles and bridges, and having power to employ and discharge such men and to oversee and to direct their work, is a vice-principal of the railway company, and the railway company is liable for his negligence whereby one of the workmen receives an injury,

(Bloyd v. St. Louis etc. R. Co., 58 Ark. 66, 41 A.S.R. 85).

The doctrine of vice-principal begins and ends with the personal duties of the master. It is the master's duty to provide a reasonably safe place in which to perform his work, and to provide and keep in proper repair reasonably safe tools, appliances and machinery for the accomplishment of the work necessary to be done,

(Hough v. T. & P. Ry. Co., 100 U.S. 213, 25 L. Ed. 612).

The true and decisive test of a vice-principal is not the relation of the employees as to each other, but the character of the act done or services performed. When a servant is entrusted with some duty of the master, which the latter owes to another servant, and which cannot, therefore, be delegated by the master, and the duty is not performed, or is negligently performed, the negligent servant is a vice-principal, for he must be regarded as the agent or representative of his employer, (B. & O. Ry. Co. v. Baugh, 149 U.S. 368, 37 L. Ed. 772).

If a servant of a railway company is entrusted with the duty that belongs to his principal as a primary duty, he is, in legal effect, a vice-principal or representative of the master, who is answerable for his negligence, whereby another servant is injured, (N. P. Ry. Co. v. Herbert, 116 U.S. 642, 29 L. Ed. 755).

In the Hough case, the Court said:

> "Those, at least, in the organization of the corporation, who are invested with controlling or superior authority in that regard represent its legal personality; their negligence, from which injury results, is the negligence of the corporation. The latter cannot, in respect of such matters, interpose between it and the servant, who has been injured, without fault on his part, the personal responsibility of an agent who, in exercising the master's authority, has violated the duty he owes, as well to the servant as to the corporation."

In the Baugh case, the Court said:

> "So, oftentimes there is in the affairs of such corporation what may be called a manufacturing

or repair department, and another strictly operating department; these two departments are, in their relations to each other, as distinct and separate as though the work of each was carried on by a separate corporation. And from this natural separation flows the rule that he who is placed in charge of such separate branch of the service, who alone superintends and has the control of it, is as to it in the place of the master. But this is a very different proposition from that which affirms that each separate piece of work in one of these branches of service is a distinct department, and gives to the individual having control of that piece of work the position of vice principal or representative of the master."

. . . . .

"If the master, instead of discharging it himself, sees fit to have it attended to by others, that does not change the measure of obligation to the employe, or the latter's right to insist that reasonable precaution shall be taken to secure safety in these respects. Therefore it will be seen that the question turns rather on the character of the act than on the relations of the employes to each other. If the act is one done in the discharge of some positive duty of the master to the survant, then negligence in the act is the negligence of the master."

In the Herbert case, the Court said:

"It is the duty of the employer to select and retain servants who are fitted and competent for the service; and to furnish sufficient and safe materials, machinery or other means by which it is to be performed, and to keep them in repair and order. This duty he cannot delegate to a servant so as to exempt himself from liability for injuries caused to another servant by its omission. Indeed, no duty required of him for the safety and protection of his servants can be transferred so as to exonerate him

from such liability. The servant does not undertake to incur the risks arising from the want of sufficient and skillful colaborers, or from defective machinery or other instruments with which he is to work. His contract implies that in regard to these matters his employer will make adequate provision that no danger shall ensue to him. This doctrine has been so frequently asserted by courts of the highest character, that it can hardly be considered as any longer open to serious question."

A master is liable for the negligence of a subordinate to whom he has entrusted the control of his entire business, or a separate or distinct branch of it, where he exercises no discretion or oversight of his own, and the agent's negligence consists in failing to supply and maintain a safe place or safe instrumentalities for the conduct of the business, for such subordinate represents the master, and the neglect of the agent is the negligence of the principal, (Willis v. Oregon etc. Navigation Co., 11 Ore. 257).

In the Willis case, the Court said:

"To constitute one vice-principal, or superior servant, the master must have committed to him the substantial control of the business, and the power to do all acts necessary to its conduct." (citing cases).

Then the Court approved language used in Mullan v. Phila. and Southern Mail Steamship Co., 78 Penn. St. 25, as follows:

"Where the master places the entire charge of his business, or a branch of it, in the hands of an agent, exercising no discretion, and no oversight of his own, the neglect of the agent of ordinary

> care in supplying and maintaining suitable instruments at cities for the work required, is a breach of duty for which the master should be liable. The negligence of the agent with such power becomes the negligence of the master."

The Court then said that Mr. Justice Deady laid down the rule as follows:

> "Where the servant is authorized and required by his employment to furnish or provide suitable material or appliances for the work in which his fellow servants are engaged, whether under his direction or otherwise, and one of them is injured by reason of his negligence or omission in this respect, the common master or employer is responsible in either case." (Referring to several cases).

Independent Contractor Doctrine

We now submit four cases from U. S. Circuit Courts wherein the facts are similar to those in case at bar, i.e., railroads engaged in interstate commerce employed independent contractors to perform their duties and employees of the contractors were injured and the railroads were held liable. These cases are known as the Margue, Cimorelli, Roth, and Barlion cases.

In Erie Railroad Company v. Margue, supra, there was involved a contract between the railroad and the Dixon Construction and Repair Company, under which contract the construction company with its own employees undertook to maintain the tracks, roadway and structures of the railroad. The contract was similar in many respects to the one involved in case at bar. Margue, an employee of the construction company, was

injured while working on the railroad tracks of the railroad and brought suit against the railroad for his injuries and the defense was that he was an employee of an independent contractor. The case turned on the effect of a contract between the railroad and construction company which the Court held to be void. In passing on the case the Court, among other things, said the maintenance of defendant's railroad tracks was essential to the exercise of its franchise rights, which it undertook to delegate to a construction company.

The Court also said that:

> "It might be well argued that the duty of a railroad company to maintain its right of way, over which it and it alone operates its trains, cannot be delegated to another, so as to relieve the company of any part of its responsibility therefor. . . . Certainly, not as to the public which it serves, and perhaps not as to those who work upon its tracks."

The Margue case could very well have been determined by the rule laid down in the Linstead case, i.e., Whose work was being done? In the Margue case he was doing the work of the Erie Railroad Company and in the case at bar appellant was doing the work of the S. P. & S. Railway Co., and that being true, the S. P. &. S., the C. & O. Railway and the Erie Railroad Company would stand in the same position and be subject to liability for the injuries sustained by the employee in question.

Cimorelli v. N. Y. C. Railway Co., 148 Fed. 2d 575 (1945; C. C. A. 6th Ohio), is a typical case involving the exact question here whether one employed by an

independent contractor may proceed against the railroad company as its employee under the Federal Employers' Liability Act. Briefly the facts were that the railroad contracted with the United States to operate in the railroad's yards a temporary place for war material in transit, identity of lading of inbound cars was to be preserved when stored and when forwarded and railroad contracted with construction company to unload and reload the cars and the railroad's superintendent selected the place in the yards where and fixed the time when cars were to be unloaded or reloaded, and had to approve in advance every item of cost and necessity of purchase of equipment; the railroad was held liable under the Federal Employers' Liability Act.

The court was of the opinion that the work involved was of such nature that the railroad was unable to devest itself of control over the details of accomplishments and was so interwoven with the work of operating a railroad that the railroad could not devest itself of control. In brief the court held that the nature and character of the work was such that its performance could not be committed exclusively to the construction company.

We suggest that the same is true of case at bar; the railroad continued to use the trestle in its interstate commerce and the nature and the character of the repair work was such that its performance could not be committed exclusively to the construction company, and as in the Cimorelli case, appellant was an employee of the railroad and not Gilpin Construction Company since

the nature and character of the repairing of the trestle was such that its performance could not be committed exclusively to the construction company, but the power of control was always with the railroad, which power it could not abdicate.

In the Cimorelli case the court said that part of the work to be done by the construction company was in the railroad yards of appellee where there was presumably frequent movement of cars and appellee controlled the place where the work was to be performed. No part of the premises was surrendered to the construction company. The whole project involved many interdependent details, the control of any one of which could not be surrendered without disorganization of the whole. From the very nature of the work its performance could not be committed exclusively to the discretion of the Duffy Company, and the court held that if the existence of the right or authority to transfer or control appears, the contractor cannot be independent, citing Atlantic Transportation Company v. Coney's Second Circuit, 82 F. 177; Reynolds v. Braithwaite, 131 Pa. 416, 18 A. 1110.

The court also said that the first question is whether appellee for whom the work was being done, had given up its proprietorship of the particular business to the Duffy Construction Company and had thus divested itself of the right of control, to the extent that it had no longer a legal right to determine the work or to direct it.

It is suggested that the rules laid down in the Cimorelli case apply to the case at bar, for in case at bar the repair of its tracks and bridges was an essential

element exacted of appellee in its franchise and the maintenance of these instrumentalities was essential to performing the functions granted appellee by its franchise. The power of control is a legal question which we submit could not be abdicated by the appellee, nor could it be exercised by the independent contractor. As in the Cimorelli case, so in case at bar, the railroad controlled the place where the work was to be performed and in which there was a frequent movement of trains and all the work the contractor had to perform had to be done subordinate to the prior right of the railroad in the operation of its trains. Furthermore the control of the bridge and tracks could not have been surrendered without disorganization of the whole and naturally from the very nature of the work for which the contractor was hired, could not be committed exclusively to the discretion of the contractor. In this connection it must be borne in mind that the contractor received train orders giving the time of trains passing over said trestle where the repair work had to be performed so that there would be no interference with interstate commerce.

In Pennsylvania Railroad Company v. Roth, supra, there was involved a contract between the railroad company and an independent contractor for work on a cost-plus basis pertaining to unloading inbound cars, assemblying and placing dunnage on ground for piling and storage of inbound shipments, stenciling, marking and placing in storage in said yards inbound shipments, etc. Roth was an employee of the independent contractor and while employed in the work sustained injuries and brought suit against the railroad company under the

Federal Employers' Liability Act. The contention of the railroad was that the employer of Roth was an independent contractor with the necessary result that Roth was not an employee of the railroad and not covered by the provisions of the Federal Employers' Liability Act. The railroad relied upon the ruling of the Supreme Court in Chicago, Rock Island and Pacific v. Bond, 240 U.S. 449, 60 L. Ed. 735. Appellee Roth relied upon Cimorelli v. N. Y. C. Railway Co. The court followed the ruling in the Cimorelli case, holding that the situation in the Rose case was substantially the same as was in the Cimorella case. Certiorari denied, 332 U.S. 830, 92 L. Ed. 404, 68 S. Ct. 208.

The Pennsylvania Railroad Company v. Barlion, supra, involved a situation similar to the Cimorelli and Roth cases. In this case the railroad agreed with the government to provide storage yards on its line and the railroad employed an independent contractor to unload cars, to stencil, mark, and store inbound shipments, to remark, reload outbound shipments, all as required by the government, and to do other incidental work required by the railroad. Barlion was employed by the independent contractor and while doing this work was injured and brought an action against the railroad under the Federal Employers' Liability Act. The respective parties made the same contention as made in the Cimorelli and Roth cases and as made in case at bar. The court said that the controversy involving the status of an independent contractor must be decided on its peculiar facts and ordinarily no one feature of the relationship is determinative. The court stressed the right

of control and not the exercise of control, saying that the right of railroad's control over the contractor rather than exercise of control by railroad determines whether the contractor is an independent contractor so that the injured employee of contractor is not entitled to the benefit of the Federal Employers' Liability Act, and further held that under the facts as related, the contractor was not an independent contractor and injured employee of contractor was entitled to the benefits of the Federal Employers' Liability Act as railroad's employee. The judgment in favor of Barlion against the railroad was affirmed on appeal. The court held that the case was controlled by the Roth case and the court, as in the Roth case, said that each controversy involving the status of an independent contractor must be decided on its peculiar facts, holding specifically that the railroad had the right of control and that it is the right of control rather than its exercise that determines whether or not a contractor is an independent contractor, adopting likewise the holding in the Roth case by saying that:

> "The whole project involved many interdependent details, the control of any one of which would not be surrendered without disorganization of the whole, and that, from the nature of the work, its performance could not be committed exclusively by the railroad to the contractor engaged in doing the unloading and reloading work and rendering the other services in question. The railroad had this right of control in the instant case to the same extent as it would in the Roth case; and it is the right of control rather than its exercise that determines whether or not a contractor is an independent contractor."

We submit that the foregoing language fits the case at bar, for the Spokane-Portland & Seattle Railway Co. under its charter had the right of control and likewise it not only had the right of control but it exercised the right by its constant use of its trains, which right could not be surrendered without disorganization of the operation of its trains; and furthermore, the duty imposed upon appellee to keep its tracks and trestles in repair was a duty that it could not abdicate and in the performance of that duty it had to vouchsafe to the workmen who did the repair work a safe place in which to do that work.

We desire to adopt what one writer said about the Barlion case, it follows:

> "This case is of greater importance than at first meets the eye. If railroads are permitted to hire independent contractors to do most of their work railroads can avoid liability under the Federal Employers' Liability Act. Under workmen's compensation acts, courts watch employers for such evasions. Many employers would like to avoid liability under the workmen's compensation act and save premiums. If they were allowed to hire independent contractors who in turn would hire the men, thus avoiding compensation coverage, such employers could hire financially worthless independent contractors who in turn would carry no compensation, with the result that the employees of judgment-proof independent contractors would receive neither compensation nor common law collections.
>
> "Similarly railroads could avoid liability under the Federal Employers' Liability Act by hiring contractors to do most of their work, and there is nothing in the law to prevent them from hiring financially worthless contractors. Such contractors would

not come under the Federal Employers' Liability Act as they are not railroads engaged in interstate commerce. Their employees in turn would have compensation rights only if they carried compensation coverage. Such independent contractors might well be financially worthless. With these possibilities in mind it should not lightly be held that claimants, who are doing exactly the same work as is often done by railroad employees, are simply employees of an independent contractor and therefore beyond the purview of the Federal Employers' Liability Act." (National Association of Claimants' Compensation Attorneys, Vol. 3, p. 206).

The same thought was expressed in Despatch Shops v. Railway Retirement Board, 153 Fed. 644, in dealing with a question pertaining to railway employees in a case brought under a different Federal Act. We quote:

> "It can be readily seen that the railroad would be free to take from under the act virtually all of their workers whose employment is in the supporting activities, through the simple expedient of setting up wholly owned corporate affiliates to perform these services. It is conceivable that everything from maintenance of way through engineering or book-keeping might be done by so-called 'independent contractors'; the application of this Act and of the other Acts passed for similar purposes and embodying the same language could be severely limited as to render them of little worth in achieving the purpose for which they were passed."

"Railroad cannot escape its charter obligations by a quibble such as this," said the Court in Philadelphia, Washington & Baltimore Railroad Co. v. Hahn, (Pa.) 12 Atl. Rep. 479. This was an action for personal injuries by Michael Hahn.

Facts: The railroad contracted with contractor Lafferty to move cars on Washington Avenue to various consignees and to bring them back empty to its yard. Contractor employed teams and men and exercised exclusive and independent control over them. While engaged in moving cars two sections of a train of empties collided and Hahn was hurt. Railroad contended it had legal right to delegate the hauling of cars and if injury was caused by contractor, the verdict should be for railroad as Lafferty was an independent contractor and the railroad was not responsible for his acts. Held:

> "The doctrine contended for on part of the plaintiff in error cannot be sustained. It contracted for the operation of a part of its road by horse-power, and, under this contract, asks to be relieved from all responsibility for the negligent acts of its contractor. We cannot agree with a proposition of this kind, for the principle, if established, might be the means of relieving the company from all its charter duties, so far, at least, as concerns the public safety. The mere question of the power by which its cars are to be moved is of no consequence. If it can contract for horse-power, so may it for steam, and it follows that it might relieve itself of all responsibility by contract with its engineers and conductors for the running of its locomotives and trains. It needs no argument to show that a railroad company cannot escape its charter obligations by a quibble such as this. The judgment is affirmed."

Philadelphia, B. &. W. R. Co. v. Karr, 38 App. D. C. 193, was an action by Karr against railroad to recover damages for injury to real estate. Railroad was authorized by Congress to construct a tunnel. Railroad con-

tracted with construction company to do the work, which was negligently done, resulting in damage to adjacent property. Railroad contended that contractor and not railroad was liable. The court held railroad responsible and upheld the verdict for plaintiff. Court, inter alia, said:

> "The liability of the principal is in each case dependent not upon the question of whether or not the tort is committed by an independent contractor, but upon whether the circumstances of the case are such as to prohibit the principal from contracting away his liability. In this instance, defendant acquired a right from Congress to construct the tunnel. The grant to defendant was a personal one. . . . The franchise carried with it the liability, and defendant, in accepting the privilege, accepted the liability which could no more be contracted away than could the franchise itself."

The Court also said that the rule to be gathered from the American cases as summarized by Thompson in his work on Negligence, 2d ed., sec. 672, was as follows:

> "It is that, whenever the independent contractor, in order to prosecute his work under his contract, must exercise, in whole or in part, a franchise granted by the legislature to his employer,—the railroad company,—the company must answer for his torts, because it is bound to see to the correct execution of the powers conferred upon it by the legislature. An enjoinment of this doctrine makes the company liable for all manner of trespasses of the contractor done while prosecuting the work under his contract; because in every such case he is acting in virtue of the franchise conferred by the legislature upon the railway company; namely, the franchise of building a railroad. Without the possession

> of that franchise, the railroad company could not be there by its own servants, nor could it be there by an independent contractor. In such a case the persons employed by the company to exercise its powers are deemed, in law, to be its servants or agents, and it is answerable for their trespasses."

Logically, the premise of the appellee would lead us to this conclusion: The railroad could delegate to Gilpin Construction Company *its duty "to maintain its railway lines and roadbed, tracks and bridges in a reasonably safe condition for its use in interstate commerce,"* and in case wrecks occurred killing hundreds of passengers, thousands of carloads of stock, maiming innumerable numbers of its train crews, etc., all due to the negligence of the contractor to whom all so injured must look. Or, let us limit the delegation to the repair of appelle's bridges, and wrecks occur—people and the train crews are killed—the logic of appellee's position would result in the same conclusion—which means that appellee shifts its duty onto another and without the consent of the state and all so injured must look to the independent contractor, irresponsible maybe, and, if so, then "without a hope of remuneration", as said in the case following.

In Lesher v. Wabash Navigation Co., supra, defendant employed independent contractor to furnish all the material and to do all the work for a price specified in the erection of a lock and dam. In the execution of the work, the contractors entered upon Lesher's land and took considerable timber for the construction of the work. Lesher sued the Wabash and not the independent

contractor. The defense was that the defendant was not liable for the acts of the contractor, which defense was sustained and on appeal reversed. The Court said:

> "The person who was injured by reason of acts done by those in the employ of the company, and in pursuance of their charter, had a right to look to the principal, who alone had authority to direct the acts to be done for compensation, and was not bound to seek redress from every servant who cut a tree or removed a stone. Were the rule otherwise, the company might, by the employment of irresponsible servants, compel the owner of the land to stand by and see it stripped of all that made it valuable, without a hope of remuneration. . . . . It may be true that it is the duty of the contractors to pay these damages, as they were bound by their contract to furnish the materials; and if so, they will be liable over to the company for the damages which the company necessarily has to pay for the acts of the contractors, but this ultimate liability of the contractors does not relieve the corporation from their primary liability to pay the damages occasioned to individuals by the exercise of the charter rights of the company, and in the mode, too, which the charter provides.
>
> " . . . The defendant is liable for the damages occasioned by the acts of the contractors which were authorized by the charter to be done by the company. As to the persons who have thus sustained damages, the contractors were the servants of the company, and their acts were the acts of the company."

The note to the foregoing case, among several authorities, cites City of Detroit v. Cory, 9 Mich. 185, and R. R. I. & St. L. R. R. Co. v. Wells, 66 Ill. 321, holding:

> "that a corporation employing contractors to execute its special franchise or privilege, and without whose

> authority the acts of the contractors would be unauthorized and tortious, is, with respect to those acts of the contractors performed under its franchises, liable as a master for the acts of his servant."

Whose Was the Work Doctrine

The Linstead case which follows, answers the proposition with respect to whose work was appellant doing. Let us bear in mind that appellant was a carpenter, hired, paid and subject to discharge by Gilpin Construction Company, the independent contractor in case at bar; by contractual arrangements between appellee and Gilpin, appellant and fellow workmen were repairing Rockton Bridge on the railroad of appellee; appellant was injured through the negligence of Gilpin in that a dangerous and unsafe place in which to work in making the repairs was furnished appellant. The question is: Who is responsible in damages to appellant? Under the rule laid down in the next case the answer is that appellee is liable because appellant was doing its work.

In Linstead v. C. & O. R. Company, supra, the U. S. Supreme Court, speaking through Mr. Chief Justice Taft, arrived at the solution of the problem by asking the question: Whose work was Linstead doing? Linstead was a conductor, hired, paid and subject to discharge by Big Four Ry. By contractual arrangements between Big Four and C. & O. Ry., Linstead and crew with Big Four engine and caboose hauled train of empties and loads of C. & O. over C. & R. Ry. tracks for Big Four connection. Linstead was killed through neg-

ligence of C. & O. train following Linstead train. The court held that the work was that of the C. & O. and that C. & O. was liable in damages for Linstead's death. Court said: We do not think that the fact that the Big Four paid Linstead's wages and that he could be discharged only by the Big Four, prevented him from being the servant of the C. & O. for the performance of this particular job.

So, in case at bar, we conclude that the work appellant was doing was the work of appellee. No one could have built that trestle, nor repaired it, but by virtue of the grant of the franchise. That duty was imposed upon appellee by the State of Washington, and it was the sole duty and the responsibility of appellee and it alone to vouchsafe the acquittance of that burden. The construction company was its agent or foreman, or as nowadays described, its vice-principal.

In case at bar appellant stands in the same relation to the appellee as did Linstead to the C. & O. Appellant in case at bar was doing the work of appellee. It was the duty imposed on appellee by its charter to see that Rockton Bridge was kept in repair. It was the duty of appellee to see that those who repaired the bridge had a safe place in which to do that work. The contract between the state and appellee could not be assigned to any one or abdicated in any way by appellee without the consent of the state. The franchise required appellee itself to perform the duties imposed upon it, and the work appellant was doing was the work of appellee.

Franchise Doctrine

In Thomas, et al. v. West Jersey R. Co., 101 U.S. 71, 25 L. Ed. 750, Mr. Justice Miller in delivering the opinion of the Court said:

> "Where a corporation like a railroad company, has granted to it by charter a franchise intended in large measure to be exercised for the public good, the due performance of those functions being the consideration of the public grant, any contract which disables the corporation from performing those functions which undertakes, without the consent of the state, to transfer to others the rights and powers conferred by the charter, and to relieve the grantees of the burden which it imposes, is a violation of the contract with the state, and is void as against public policy."

In Knahtla v. O. S. L. Ry. Co., 21 Ore. 136, this question of delegation of duties imposed by franchise was settled long ago in Oregon by the Supreme Court speaking through Justice Hon. Robert S. Bean, later a U. S. District Judge of the District of Oregon. It was for personal injuries due to negligence of the defendant and its servants. The defense was floods beyond its control, fellow servant and contributory negligence. The court in classic, terse language said:

> "There is no doubt that it is the duty of a railroad company to furnish for the use of its employes a reasonably safe track, which necessarily includes bridges, and to exercise reasonable care to keep and maintain the same in a good and safe condition; to cause as frequent and thorough inspection of its roadbed and track as under the circumstances may reasonably be necessary for the purpose of discovering any defects therein; to exercise care in the

selection and retention of its servants, and to adopt such rules and regulations as may reasonably be necessary to guard against accident; and if the master fail to perform any of these duties and a servant is injured, he is liable in an action for damages suffered by such servant, and any duty which the master is required to perform for the safety of his servant cannot be delegated to any servant of any grade so as to exempt the master from liability for an injury resulting to a servant from its nonperformance. (Anderson v. Bennett, 16 Or. 515; Miller v. S. P. Co., 20 Or. 285)."

In the Miller case (Miller v. Sou. Pac. Ry., 20 Ore. 285), referred to by the Court, Chief Justice Lord said:

"We begin by saying that the principle that any duty which the master is required to perform for the safety and protection of his servants cannot be delegated to any servant of any grade so as to exempt the master from liability to a servant who has been injured by its non-performance, cannot be questioned. Nor can it be questioned that among these duties are not included the duty of a railroad company to keep its road-bed and track, rolling-stock, tools, machinery and appliances in good and safe condition; to cause as frequent and thorough inspection of these as can be done consistently with the conduct of its business for the purpose of discovering any defects that may occur from accidental causes, or the effects of wear and tear, or the progress of decay; to exercise care in the selection of its servants, and in their retention in its service; and to adopt such rules and regulations as are calculated to guard against accidents, and to make the servants in its employ reasonably safe. Our inquiry then is: Was the character of the act performed by the servant such an act as the law implies a contract duty upon the part of the master to perform?—for if it was, then such servant, in

respect to that act, ceases to be a servant, and becomes an agent or vice-principal."

In Oregon v. Portland General Electric Company, supra, the Supreme Court adopts the rule that a railroad corporation can exercise no power or authority which is not granted to it by the charter under which it exists, or by some other act of legislature which granted that charter. That it is universally held that all grants of a franchise are to be strictly construed against the grantee and that nothing passes by implication. That a railroad corporation to which a franchise has been granted with no power to transfer, has no power to transfer and a transfer is void, and does not relieve the franchise of any of the burdens imposed by the act of creation, and that where a railroad corporation has granted to it by charter a franchise intended in a large measure to be exercised for the public good, the due performance of those functions being the consideration of the public grant, any contract which disables the corporation from performing those functions which undertakes, without the consent of the state, to transfer to others the rights and powers conferred by the charter, and to relieve the grantee of the franchise of the burden which it possesses, is a violation of the contract with the state, and is void as against public policy, and that such corporation cannot absolve itself from the performance of its obligations wihout the consent of the legislature.

To uphold its decision the court cites many cases from the Supreme Court of the United States and many state courts.

Breach of Statute Doctrine

Let us pursue this matter a step further: Surely the requirements of a franchise are as obligatory and on as high plane as the provisions of the Safety Appliance Act, if not higher. And a failure to comply with the requirements of the Federal Safety Appliance Act is an actionable breach of duty toward travellers on highways as well as toward employees and passengers. So in case at bar, where the franchise made it the duty of appellee to maintain and keep in repair its tracks and bridges and where it was likewise the duty of appellee to see that a safe place was provided to those doing its work,— its failure to comply with its franchise, we maintain, is an actionable breach of duty toward appellant which appellee cannot successfully challenge no more than it could challenge any breach of the statute.

> Brady v. Terminal R. Assoc., 303 U.S. 10, 82 L. Ed. 615;
>
> Fairport P. & E. Railroad v. Meredith, 292 U.S. 589, 78 L. Ed. 1446;
>
> L. & N. Railroad v. Layton, 243 U.S. 617, 61 L. Ed. 931, 37 S. Ct. 456.

Mr. Justice Hughes, in Brady v. Terminal R. Association, sums up the situation. This was an action under the Safety Appliance Act against the Terminal Railroad Association by Brady, an employee of the Wabash Railroad, which railroad he first sued and judgment reversed on the ground that the Wabash had not accepted the car and was not responsible, (83 A.L.R. 655). Thereupon the present action. The Court held that:

> 1. "The obligation to provide secure handholds on the roofs of freight cars, imposed by the Federal Safety Appliance Act, is owed to the employee of another railroad company whose duty it is to inspect cars tendered to his employer for transportation."
>
> 2. "The duty imposed by the Federal Safety Appliance Act is an absolute one; and a railroad company is not excused by any showing of care, however assiduous."
>
> 3. "A railroad employee is not excluded from the benefits of the Federal Safety Appliance Act by the fact that his work is that of inspection for the purpose of discovering defects of the sort which caused his injury."

In rendering the opinion, the Chief Justice used the following language:

> "The liability springs from its being made unlawful to use cars not equipped as required,—not from the position of the employee may be in or the work which he may be doing at the moment when he is injured, provided the defective equipment is the proximate cause of the injury,"

which language was used by the Court in L. & N. R. Co. v. Layton, supra.

In Louisville & Nashville Railroad v. Layton, supra, an action by Layton, an employee of the railroad, for damages due to defective brakes. In affirming the verdict, the Court dealt upon the purpose of such legislation, saying:

> "By this legislation the qualified duty of the common law is expanded into an absolute duty with respect to car couplers, and if the defendant railroad companies used cars which did not comply with the standard thus prescribed, they violated

the plain prohibition of the law, and there arose from that violation a liability to make compensation to any employee who was injured because of it. (citing cases).

"While it is undoubtedly true that the immediate occasion for passing the laws requiring automatic couplers was the great number of deaths and injuries caused to employees who were obliged to go between cars to couple and uncouple them, yet these laws as written are by no means confined in their terms to the protection of employees only when so engaged. The language of the acts and the authorities we have cited make it entirely clear that the liability in damages to employees for failure to comply with the law springs from its being made unlawful to use cars not equipped as required,—not from the position the employee may be in, or the work which he may be doing at the moment when he is injured. This effect can be given to the acts and their wise and humane purpose can be accomplished only by holding, as we do, that carriers are liable to employees in damages whenever the failure to obey these Safety Appliance Laws is the proximate cause of injury to them when engaged in the discharge of duty."

Fairport, Painesville & Eastern Railroad Company v. Meredith, supra, was an action for injuries resulting from a collision at a railway crossing between automobilist and a train of the railroad. Train had good brakes, but air was disconnected,—a violation of the Safety Appliance Act. Verdict for Meredith sustained. Court held that:

1. "The qualified duty imposed by common law on a railroad company to provide and keep in reasonably safe condition adequate brakes for the control of its trains is converted by the Federal Safety Appliance Act into an absolute duty, from the vio-

lation of which there arises a liability for an injury resulting therefrom to any person falling within the terms and intent of the act."

2. "The nature of the duty imposed by a statute and the benefits resulting from its performance usually determine what persons are entitled to invoke its protection."

3. "Failure to comply with the requirements of the Federal Safety Appliance Act that power brakes be used in operating trains in an actionable breach of duty towards travelers on highways as well as towards railroad employees and passengers."

In Michelson v. Erie Ry., (1929) 106 N. J. L. 147, 147 Atl. 535, 16 Neg. cases at p. 294, plaintiff was an employee of Fred Snare Corp., the consignee of logs hauled on Erie Railway flat cars delivered to consignee. Logs on the flat cars were supported by stakes and wires. Plaintiff chopped one stake, other gave way. Logs rolled off flat car onto plaintiff and killed him. Inspection disclosed stakes which broke were decayed which was not a latent defect.

HELD: It was the duty of the railway to inspect said stakes,—it owed the same duty to plaintiff, the employee of consignee, as to its own employees. Verdict for plaintiff affirmed. (This is the Court which 10 years earlier decided Drago v. Central Ry. of N. J., 93 N.J. 176, 103 Atl. 803 in 1918.)

Employer-Employee Doctrine

The criterion of applicability of the Federal Employers' Liability Act is the employee's "occupation" at the time of his injury in interstate transportation or

work so closely related thereto as to be practically a part of it.

N. Y. N. H. & H. v. Bezue, 284 U.S. 415, 76 L. Ed. 370, 52 Sup. Ct. 24, 77 A.L.R. 1370;

Shanks v. D. L. & W., 239 U.S. 556, 60 L. Ed. 436;

C. & E. I. v. Indus. Com., 284 U.S. 296, 76 L. Ed. 304, 52 Sup. Ct. 151.

The mere fact of employment by an interstate railroad does not bring an employee within the Federal Employers' Liability Act.

N. Y. N. H. & H. v. Bezue, 284 U.S. 415, 76 L. Ed. 370;

D. L. & W. v. Yurkonis, 238 U.S. 439, 59 L. Ed. 1397, 35 Sup Ct. 902;

C. B. & Q. v. Harrington, 241 U.S. 177, 60 L. Ed. 941, 36 Sup. Ct. 517;

N. Y. C. v. White, 243 U.S. 188, 61 L. Ed. 667;

I. A. C. v. Davis, 259, U. S. 182, 66 L. Ed. 888, 42 Sup. Ct. 489.

Nor the mere fact of non-employment by a railroad engaged in interstate commerce does not preclude an employee from protection of the Federal Employers' Liability Act.

Cimorelli v. N. Y. C., 148 F. 2d 575;

Erie Ry. v. Margue, 23 F. 2d 664;

Penn. Ry. v. Roth, 163 F. 2d 161;

Penn. Ry. v. Barlion, 172 F. 2d 710;

Annotation: Who within and without F. E. L. A., 77 A.L.R. 1374-81;

Master & Servant, Secs. 91-97 A.L.R. Digest.

In truth a violation by the railroad of the Safety Appliance Act affords relief to a member of the public if injured by reason of the infraction of said Act.

Fairport, P. & E. Railroad v. Meredith, 292 U.S. 589, 78 L. Ed. 1446.

We submit that the contention in behalf of appellant finds support in the trend and policy of decisions of the U. S. Supreme Court and certain circuit courts, as well as in the statutes of the Congress. The benefits of the Federal Employers' Liability Act have been extended to seamen by Sec. 33 of The Merchant Marine Act of June 5th, 1920, 46 U.S.C.A., Sec. 688, known as the Jones Act. And by construction of the courts the rights and benefits of the obligation of seaworthiness, traditionally owed by an owner of a ship to a seaman, have been extended to a stevedore injured while working aboard the ship, doing a seaman's work, though employed by an independent stevedore company, (Seas Shipping Co. v. Sieracki, supra).

Sieracki was employed by an independent stevedoring company which was under contract with Seas Shipping Co. to load its ship. Sieracki was on the vessel loading cargo. The shackle supporting the boom broke at its crown causing the boom and tackle to fall and injure Sieracki. He sued three concerns. District court held Bethlehem Steel Co. and Bethlehem Sparrow's Point liable due to defect in forging shackle, but held favorable to Seas Shipping Co. On appeal Circuit Court held that Sieracki was entitled to same rights as seamen and should recover against Seas Shipping Co. for the

ship's lack of seaworthiness. Aff. by U. S. Supreme Court.

In the Sieracki case, supra, in rendering its opinion the Court laid down principles and utterances applicable to case at bar:

> An employee of a stevedoring company engaged in loading a ship, injured while working aboard the ship by a defect in its equipment amounting to unseaworthiness, may recover damages from the shipowner.
>
> For injuries incurred while working aboard a ship in navigable waters a stevedore is entitled to the seaman's traditional and statutory protection regardless of the fact that he is employed immediately by another than the owner.
>
> The obligation of seaworthiness imposed upon the owner of a vessel in favor of those in the vessel's service is one which he cannot delegate; nor can he contract it away as to any workman within the scope of its policy.

This rule laid down in the Sieracki case, supra, was followed by this Court in United States v. Arrow Stevedoring Co., 175 F. 2d 329.

In Standard Oil Co. v. Anderson, supra, a leading case on the "loaned servant doctrine", but not involving the application thereof under the Federal Employers' Liability Act, applied the same reasoning and obtained the same result as in the Sieracki case and applied the test, whose work was it.

The plaintiff was a longshoreman employed by a master stevedore who under contract with defendant was engaged in loading ship Susquehanna with oil.

Plaintiff was working in hold where without his fault he was injured by load of oil unexpectedly lowered. All loading was done by employees of stevedore except operation of winch by winchman, an employee of defendant.

The question for determination was whether winchman was the servant of defendant or of stevedore at the time plaintiff was injured. If he was the servant of defendant then defendant was responsible; if not, that ends the case. The winchman was hired and paid by defendant who alone had the right to discharge him. The stevedore had no control over the movements and conduct of the winchman except that the hours of labor of winchman necessarily conformed to the hours of labor of plaintiff. The winchman had to rely upon employees of stevedore for signals for hoisting and lowering of loads of cases of oil. The negligence claimed was lowering a draft of cases before receiving signal. Verdict for plaintiff. Affirmed by Circuit and U. S. Supreme Courts.

The Court laid down the test by which it could be determined whether appellee was liable, namely: "Whose is the work being performed,—a question which is usually answered by ascertaining who has the *power of control* in the performance of their work. Here we must carefully distinguish between authoritative direction and control, and mere suggestion as to details or the necessary cooperation, where the work furnished is part of a larger undertaking."

It is respectfully asserted that a common carrier,

under a franchise from a commonwealth, can never lose the power to control, can never delegate that duty, nor escape the responsibility. The absurdity of a contrary contention is readily seen by pursuing the matter to its logical extremes, i.e.: Supposing the carrier sub-let to various and sundry contractors its various and sundry duties,—its repairs of bridges to A,—its trains to B, its signal system to C, its roadbed to D, et ad infinitum. To state the question is to give the answer.

The rule herein established was followed by Chief Justice Taft in Linstead v. C. & O. R. Co., supra.

Appellee Authorities

Appellee will rely perhaps on C. R. I. & P. v. Bond, 240 U.S. 449, 60 L. Ed. 735. In that case the railway was in the position where it could in fact turn over the work in question to Turner, an independent contractor, and allow him to carry on the work as an independent contractor. In the work Turner could have carried on his job 24 hours of the day without any interference with the operation of the trains and the commerce of the Rock Island Railroad. That is to say, the freedom of action of the Rock Island was in no way curtailed and the statute as interpreted at that time in 1915 has no application to the situation as of the present time or at any time since the 1939 Amendment but eliminating the 1939 Amendment entirely, the Bond case as it is called, is no criterion for the case at bar. In case at bar, appellee could not grant to the Gilpin Construction Company the freedom of action that the Rock Island

granted to Turner. Appellee was, by franchise with the state in carrying on its interstate commerce, bound to keep itself in the position where it could control the bridge and could use it in its daily interstate commerce, which in fact it did use, and Gilpin Construction Company subordinated its work to the rights of appellee in that Gilpin Construction Company received and observed the train orders of appellee issued from day to day in the operation of its trains over the trestle in question. Appellee was also duty bound by its franchise to maintain and keep in repair its instrumentalities used by it in its interstate commerce. This was a duty which it could not abdicate. This was an essential function of appellee which it could not delegate to any body. Neither the appellee nor the Rock Island in 1915 could have delegated to an independent contractor the repair of the tracks and trestles used by them in interstate commerce. The power of control lodged in the common carrier is a power that it cannot delegate.

It is rather interesting to refer to Kamboris v. O. W. R. & N., 75 Ore. 358, decided in 1915 by the Supreme Court of Oregon, dealing with the same subject as by the Illinois Court in the Bond case. Be it said to the credit of the Oregon Court that it laid down the law in 1915 which has been the law everywhere since the 1939 Amendment to the Federal Employers' Liability Act.

The Bond case and the case of Casement v. Brown, and like authorities, are disposed of by A. C. L. v. Tredway, supra, in the following language:

> "They are inapplicable to the instant case, for the reason that the duties of the servant in question

> were of such a character, as above noted, that they could not be assigned by the defendant to an independent contractor so as to release itself from the position of responsibility for their proper discharge. That is to say, the defendant could not abdicate its position of master with regard to the plaintiff's intestate in the instant case, by delegating or assigning its duty of control of such servant to any independent contractor. It is not a case in which the doctrine of independent contractor is applicable. See authorities collated in note to 66 L.R.A. pp. 119, 136, 137, 140, 142; Boucher v. New York, N. H. & H. R. Co., supra, 13 L.R.A. (N.S.) 1177, and authorities collated in note thereto."

Other authorities on C. R. I. & P. v. Bond and against the contention of appellee are:

Kamboris v. O. W. R. & N., 75 Ore. 358, 146 Pac. 1097;

Erie Railway Co. v. Margue, 23 Fed. 2d 664;

Cimorelli v. New York Central Railroad Co., 148 Fed. 2d 575;

Pennsylvania Railroad Co. v. Roth, 163 F. 2d 161.

Penn. Ry. Co. v. Barlion, supra, 172 F. 2d 710.

So in conclusion, let us close by observing that the relationship of master and servant existed between appellee and appellant, but did not exist between the independent contractor and appellant. Appellant rendered and discharged and appellee received and accepted a service of a character with respect to which the duty of the railroad under its franchise was non-assignable. The State of Washington granted an exclusive prerogative to appellee, and, only of appellee could the state exact

performance. The duty was the exclusive obligation of appellee and that duty could not be evaded, assigned or delegated, nor could it be contracted away. All who rendered services for appellee pursuant to that duty, or in its discharge were servants of appellee, and the independent contractor was its agent or vice-principal.

And the responsibility to provide appellant and his fellow servants a safe place in which to repair the bridges was the responsibility of appellee and it alone must bear the blame for the injuries sustained by appellant.

These principles of law form the crux of this case. The parties admit and the court has found that, "It was the duty of defendant to maintain its railway lines and its roadbed, tracks and bridges in a reasonably safe condition for its use in interstate commerce." We contend that this is a positive duty, that it is absolute, that it is non-delegable, that it is non-assignable, that it is a personal duty, that the railroad cannot in law abdicate its power of *control* of the instrumentalities that are indispensable in its performance of the duties imposed upon it by its franchise. The responsibility is constant, it never shifts. True, railroads do permit other railroads to use their roads, their right of ways, their bridges, sometimes a railroad assigns to another road the cost and obligation of maintaining signal system along its tracks, sometimes a railroad agrees with contractors to repair its bridges, etc., but in all of these instances the railroad which obtained the franchise is responsible to those sustaining injury because of negligence on the part of that one selected by the carrier to perform its

work and because the "power of control" rested and remained in the railroad,—grantee of the franchise,—who could not bargain it away or abdicate it even if it so desired. And if, by exigencies of whatever nature, it did contract, assign or lease such personal, positive, unalienable, non-delegable duty and negligence occurred in the execution or performance thereof and damages to anyone occurred, the franchise holder must answer.

CONCLUSION

Therefore, it is respectfully contended that the District Court made error prejudicial to the rights of the appellant; and that the judgment of the District Court should be reversed and the action remanded to the Trial Court for trial upon the merits.

Respectfully submitted,

Elton Watkins,
Attorney for Plaintiff-Appellant.

No. 12882

United States
COURT OF APPEALS
for the Ninth Circuit

ROBERT O. NORMAN,
Appellant,

v.

SPOKANE, PORTLAND AND SEATTLE RAILWAY COMPANY, a corporation,
Appellee.

BRIEF FOR APPELLEE

On Appeal from the United States District Court for the District of Oregon.

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STEVENS-NESS LAW PUB. CO., PORTLAND 6-51

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BRIEF FOR APPELLEE

On Appeal from the United States District Court for the District of Oregon.

STATEMENT OF THE CASE

This action was commenced in the United States District Court for the District of Oregon by a resident of the State of Washington against a Washington corporation (Tr. 11). Appellant, an employee of Gilpin Construction Company, brought suit against appellee

under the Federal Employers' Liability Act (hereinafter referred to as F.E.L.A.) to recover damages for personal injuries sustained by him on January 10, 1947, when he fell a distance of between sixty and seventy feet to the ground from an Oregon railroad trestle, known as Rockton Bridge, owned and used by appellee (Tr. 12, 13).

This appeal is taken from a judgment of dismissal entered after trial upon findings of fact and conclusions of law (Tr. 11-16). The findings are based in part upon a stipulation between the parties, filed after the case was submitted, and in part upon testimony and evidence presented by the parties at a separate trial of the issue of appellee's liability to appellant under the F.E.L.A. The trial was had before the court sitting without a jury (Tr. 8).

The record which appellant has designated in this Court consists only of Judge Fee's opinion, the findings of fact and conclusions of law, the judgment order, the notice of appeal, the clerk's certificate, and the statement of points and designation of record. Appellant has not included the oral testimony or any exhibits in the transcript of record.

Hence, the findings of fact are conclusively presumed to be supported by the evidence and cannot be questioned here. The only issue on this appeal is whether the findings support the judgment of dismissal. (*Griffiths Dairy, Inc. v. Squire,* 138 F. (2d) 758, 760 (C.A. 9)).

STATEMENT OF THE FACTS

On January 10, 1947, the date of the accident which gave rise to this action, and for a long time prior thereto, appellant was employed by and working for Gilpin Construction Company (hereinafter referred to as Gilpin) as a member of one of its construction crews which was engaged on that day in the work of repairing and enlarging Rockton Bridge. At the time of the accident, and for a long time prior thereto, appellant was and had been acting under the direction and control of Gilpin, and not of the appellee (Tr. 13).

On or about October 27, 1944, appellee entered into a contract with Gilpin whereby for a sufficient consideration the latter undertook and agreed to do repair and maintenance work on appellee's trestles and bridges, including Rockton Bridge, and to furnish the equipment, tools and labor to do that work (Tr. 12). Gilpin, an Oregon corporation, had been engaged for many years in a general contracting business, including the construction, maintenance and repair of railroad trestles and bridges. It was a wholly independent corporation (Tr. 12).

The relationship established by the contract and the performance of the contracting parties thereunder at the time of the accident was that of true independent contractor and contractee (Tr. 13). Gilpin had unrestrained power to and did direct the manner and method of doing the work of repairing and maintaining the Rockton Bridge, and to choose its employees. Appellee made no

attempt to delegate any of its responsibility to Gilpin, but by its contract with Gilpin simply entered into a normal transaction of letting necessary repair work to an independent contractor (Tr. 14). Gilpin was in fact a true independent contractor acting under a *bona fide* contract which was not designed or intended as, and in fact was not, a scheme or an artifice to evade the provisions of the F.E.L.A. (Tr. 13).

In spite of the fact that appellant does not question the sufficiency of the evidence to support these findings, he has persisted throughout his brief (App. Br. pp. 2, 8, 18, 27, 35, 37, 40, 47, 60) in making factual assertions, some *dehors* the record, and others in direct contradiction to the findings. The statement is made, and reiterated many times, that during the construction work appellee retained control and the constant use of the bridge and tracks (App. Br. pp. 2, 35, 37, 40 and 60). Furthermore, appellant baldly states as a fact that Gilpin was appellee's "agent or foreman, or as nowadays described, its vice-principal." (App. Br. p. 47). Again, it is said, "the appellee at all times had complete and absolute control as a proprietor of the premises and at any time it could stop or continue and determine the way in which the work should be done—" (App. Br. p. 27). Still again, appellant suggests that the work was of such a nature that "in fact" appellee "was unable to divest itself of control." (App. Br. p. 8). Although there is nothing in the findings to indicate that the work being performed at the time of the accident was dangerous, appellant assumes that to be the fact (App. Br. p. 18).

While the decision of this Court will be controlled by the facts shown in the record before it (*Leonard v. Field*, 71 F. (2d) 483, 487 (C.A. 9)), appellee feels that it is incumbent at the outset to point out the wide discrepancy between the actual facts before this Court, and what appellant has assumed them to be. This coloring of the facts has naturally affected appellant's viewpoint in regard to the correct principles of law governing this case.

STATUTES INVOLVED

Section 1 of the Federal Employers' Liability Act, as amended (45 U.S.C.A., Sec. 51), provides as follows:

> "Every common carrier by railroad while engaging in commerce between any of the several States or Territories, or between any of the States and Territories, or between the District of Columbia and any of the States or Territories, or between the District of Columbia or any of the States or Territories and any foreign nation or nations, shall be liable in damages to any person suffering injury while he is employed by such carrier in such commerce, or, in case of the death of such employee, to his or her personal representative, for the benefit of the surviving widow or husband and children of such employee; and, if none, then of such employee's parents; and, if none, then of the next of kin dependent upon such employee, for such injury or death resulting in whole or in part from the negligence of any of the officers, agents, or employees of such carrier, or by reason of any defect or insufficiency, due to its negligence, in its cars, engines, appliances, machinery, track, roadbed, works, boats, wharves, or other equipment.

> "Any employee of a carrier, any part of whose duties as such employee shall be the furtherance of interstate or foreign commerce or shall, in any way directly or closely and substantially, affect such commerce as above set forth shall, for the purposes of this chapter, be considered as being employed by such carrier in such commerce and shall be considered as entitled to the benefits of this chapter."

Section 5 of the same chapter (45 U.S.C.A., Sec. 55) provides, in pertinent part:

> "Any contract, rule, regulation, or device whatsoever, the purpose or intent of which shall be to enable any common carrier to exempt itself from any liability created by this chapter, shall to that extent be void: * * * ."

SUMMARY OF ARGUMENT

A plaintiff who invokes the special benefits of the Federal Employers' Liability Act must establish that at the time of the occurrence of the injury: (1) the defendant was a common carrier by railroad in interstate or foreign commerce, and (2) that he suffered injury while he was employed by the carrier in such commerce (*Kelly v. Delaware River Joint Commission,* 85 F. Supp. 15 (D.C. Pa.)). It is fundamental that " . . . Congress used the words 'employee' and 'employed' in the statute in their natural sense, and intended to describe the conventional relation of employer and employee." (*Robinson v. Baltimore and Ohio Railroad Co.,* 237 U.S. 84, 35 S. Ct. 491, 59 L. Ed. 849; *Hull v. Philadelphia & R. Ry. Co.,* 252 U.S. 475, 40 S. Ct. 358, 64 L. Ed. 670).

In this case, the unchallenged findings demonstrate that at the time of the occurrence of his injury, appellant was employed by and working for Gilpin Construction Company as a member of one of its construction crews, that he was acting under Gilpin's exclusive direction and control, and that Gilpin had the unrestrained power to and did direct the manner and method of doing the work, and also had the power to choose its employees (Tr. 13-14). Consequently, appellant, not being an employee of appellee, cannot maintain this action under the F.E.L.A.

The stipulation between the parties and the findings further establish that Gilpin was in fact a true independent contractor acting under a *bona fide* contract which was not designed or intended as, and in fact was not, a scheme or artifice to evade the provisions of the F.E.L.A. (Tr. 10, 13). Accordingly, appellant cannot contend that the contract, which is not included in the record, is void, as in violation of Section 5 thereof (45 U.S.C.A., Sec. 55).

The experienced District Judge, whose opinion shows that he devoted much time and study to this case, concluded (Tr. 6):

> "Of the hundreds of cases which have been reviewed by the Court, none suggests that an employee of a true independent contractor erecting or repairing a bridge on a right of way becomes an employee of the railroad company because the duty of construction and repair of such bridges cannot be delegated. No case suggests that the employee of an independent contractor becomes an employee pro

hac vice under such circumstances. In view of the history of such construction by independent contractors ever since railroads have been in existence, it is necessary to answer that the employees of the contractor do not become employees of the railroad by any legal theory. This does not derogate from the duty of the railroad to construct and repair such structures. But the duty is not to plaintiff but to its passengers."

ARGUMENT

A. Employees of a Bona Fide Independent Contractor May Not Sue a Railroad Under the F.E.L.A.

The leading United States Supreme Court case so holding is *Chicago, R. I. & P. R. Co. v. Bond,* 240 U.S. 449, 36 S. Ct. 403, 60 L. Ed. 735, which this Court recently cited with approval in *Brown v. Luster,* 165 F. (2d) 181, 184, note 2. In the *Bond* case, the railroad entered into a contract with the plaintiff's intestate for the shoveling of coal on a per-ton basis. He was to remove all coal from cars into coal chutes in such amount and at such times as required by the company. He was also to break the coal into appropriate sizes, gather up coal that fell from the chute pockets to the ground, and place the same on cars or engines as desired by the company. The railroad was to furnish the necessary tools for the job and to keep a record of all coal delivered. Payments were based on the amount of coal handled as determined by daily reports of cars unloaded by the decedent. He was required to submit a report

and furnish a certification from each engine man, hostler or other employee showing the number of tons of coal delivered to any engine. The Supreme Court reversed a judgment in favor of the plaintiff in an action brought under the F.E.L.A. on the ground that under the contract the railroad had not retained the right to direct the manner in which the work was to be done or to control the results to be accomplished. Therefore, he was an independent contractor and not entitled to the benefits of the F.E.L.A. The Supreme Court also rejected the contention that the contract was a violation of Section 5 of the F.E.L.A., and held that the decedent was not incompetent to assume the relationship of an independent contractor to the railroad.

Two other United States Supreme Court decisions, *Robinson v. Baltimore and Ohio Railroad Co.,* 237 U.S. 84, 35 S. Ct. 491, 59 L. Ed. 849, and *Wells-Fargo & Co. v. Taylor,* 254 U.S. 175, 41 S. Ct. 93, 65 L. Ed. 205, reach a similar result. They hold that where a railroad contracts with another company for the furnishing of facilities, or services, or the performance of work necessary to the fulfillment of its own obligations to the public, the employees of such other company remain the employees of the contractor and may not claim the benefits of the F.E.L.A.

These decisions have never been expressly or impliedly overruled by the United States Supreme Court. Their principles have been recently approved by this Court in its *per curiam* affirmance of Judge Goodman's decision in *Gaulden v. Southern Pacific Company,* 78 F.

Supp. 651 (D.C. Cal.), aff'd 174 F. (2d) 1022, "on the grounds and for the reasons stated in the opinion of the trial court." In that case, an employee of Pacific Fruit Express Company sued his employer and the railroad under the F.E.L.A. The court dismissed the action as against the express company on the ground it was not "a common carrier by railroad." It was also contended that the express company was no more than railroad's agent, and hence that the latter was the plaintiff's real employer and subject to suit under the F.E.L.A. However, the district court found that the Protective Service Contract, by its terms, as well as by the manner of its performance, constituted the parties independent contractors. The court also found that the express company performed with its own employees at its own expense, and that no right of control over the manner and means of performance had been reserved, even though certain conditions of performance and means of cooperation and assistance were specified in the contract. It was held that these provisions which were directed to the successful accomplishment of the contract's broad objectives did not invest the railroad with control of the method of performance. Therefore, the action was dismissed against both defendants.

The *Gaulden* case has been approved and followed in recent decisions of other federal and state courts.

In *Kelly v. Delaware River Joint Commission,* 85 F. Supp. 15 (D.C. Pa.), the plaintiff at the time of injury, was engaged in painting a portion of a bridge structure overhanging a railroad right of way. He was

hired by J. I. Hass Co., Inc., a painting contractor then engaged in maintaining the bridge and the railroad right of way. He sued The Delaware River Joint Commission, Philadelphia Transportation Co. and J. I. Hass Co., Inc., under the F.E.L.A. On motion, the action was dismissed against the employer on the ground that it was not a "common carrier by railroad." Although the other two defendants were deemed "common carriers by railroad," their motions to dismiss were also granted on the ground that no suit "* * * can be entertained if the injury is sustained by an employee of an independent contractor." The *Bond* and *Gaulden* cases were cited by the court as supporting this established principle of law.

The *Gaulden* case was relied upon by the Supreme Court of Utah in *Moleton v. Union Pacific R. R. Co.,* 219 P. (2d) 1080, where a judgment of non-suit was affirmed in an action under the F.E.L.A. brought against the railroad and the Pacific Fruit Express Company by an employee of the latter whose job was to descend into refrigerator car bunkers to regulate burning heaters which generate carbon monoxide gas. The plaintiff contended that in performing his duties he was in reality doing the railroad's work and was under its control and direction. However, the court found that the work he was doing was for his own employer, although the railroad would ultimately benefit from it. It was further held that the evidence did not indicate a control by the railroad of the performance of his duties, but only suggestions as to details. The court con-

cluded that he had no right to sue either the railroad or his employer under the F.E.L.A.

The Court of Appeals for the Sixth Circuit in *Jones v. New York Central R. Co.,* 182 F. (2d) 326, cert. den. 340 U.S. 850, 71 S. Ct. 78, 95 L. Ed. 38, also has recently cited the *Gaulden* case with approval. This was a suit brought under the F.E.L.A. by an express messenger for Railway Express Agency, Inc., against his employer and the railroad for damages on account of injuries sustained while he was reboarding an express car forming part of a train. A judgment of dismissal after trial upon a stipulation of facts was affirmed on appeal. The court held that the express company was not a "common carrier by railroad." The dismissal of the action as against the railroad was affirmed upon the authority of the *Robinson* case. The court held that to treat the plaintiff as an employee of the railroad which did not employ him would be to disregard the separate legal entity of the express company, and that there was "no showing of special circumstances to justify such a result." (182 F. (2d) at p. 328).

Other decisions which accord with the United States Supreme Court cases cited above, and with this Court's decision in the *Gaulden* case, are listed below. They all hold that a railroad company may commit work of all types to independent contractors without being subject to suit under the F.E.L.A. by employees of the contractor:

1. *Polluck v. Minneapolis & St. L. R. Co.,* 40 S.D. 186, 166 N.W. 641 (S. Ct. S.D.), cert. den. 248

U.S. 558, 39 S. Ct. 6, 63 L. Ed. 421, (contract to keep coal chutes filled and ashes out of turntable pit);

2. *Drago v. Central R. Co. of New Jersey,* 93 N.J. L. 176, 106 A. 803 (Ct. of E. and A. N.J.), cert. den. 251 U.S. 553, 40 S. Ct. 118, 64 L. Ed. 411, (contract to load and unload freight);

3. *Bugg v. Sanders,* 121 S. 410 (S. Ct. Ala.), (contract covering the transfer of freight from bad order to good order cars);

4. *Reynolds v. Addison Miller Co.,* 143 Wash. 271, 255 P. 110 (S. Ct. Wash.), (contract to furnish ice and to ice railroad cars);

5. *Orange v. Pitcairn,* 280 Ill. App. 566 (App. Ct. Ill.), (contract to reconstruct section of railroad track);

6. *Lees v. Chicago & N. W. Ry. Co.,* 339 Ill. App. 277, 89 N.E. (2d) 418 (App. Ct. Ill.), (contract to remove old damaged pile cluster and to install new one as part of railroad bridge);

7. *Klar v. Erie R. Co.,* 118 Ohio St. 612, 162 N.E. 793 (S. Ct. Ohio), cert. den. 279 U.S. 818, 49 S. Ct. 342, 73 L. Ed. 975, (contract to handle repair work on railroad engines and cars);

8. *Pittsburgh C. C. & St. L. R. Co. v. Parker,* 191 Ind. 686, 132 N.E. 372 (S. Ct. Ind.), (contract to build concrete bridges);

9. *Bogart v. New York Cent. & H. R. R. Co.,* 171 App. Div. 652, 157 N.Y.S. 420 (App. Div. N.Y.), (contract to carry freight);

10. *Missouri K. & T. R. Co. v. West,* 38 Okla. 581, 134 P. 655 (Sup. Ct. Okla.), (contract to handle baggage).

B. The Authorities Cited by Appellant Do Not Govern This Case.

Appellant has cited fifty-two cases in his brief. They are all distinguishable on their facts and on the questions of law there presented. To discuss them all in detail would necessitate extending this brief to inordinate lengths. However, for the purpose of analysis, they may be grouped and classified on the basis of the following controlling distinctions:

I. Employer-Employee Relationship Admitted.

In such cases as *Panama R. Co. v. Minnix,* 282 Fed. 47 (C.A. 5); *Chicago Junction R. Co. v. King,* 169 Fed. 372 (C.A. 7); aff'd on procedural grounds 222 U.S. 222, 32 S. Ct. 79, 56 L. Ed. 173; *Wilczynski v. Pennsylvania R. Co.,* 90 N.J.L. 178, 100 A. 226 (Ct. E. and A. N.J.); *Roberg v. Houston & T. C. R. Co.,* 220 S.W. 790 (Ct. of Civ. App. Tex.); *Blessing v. Camas Prairie R. Co.,* 3 W. (2d) 266, 100 P. (2d) 416 (S. Ct. Wash.); *Porter v. Terminal R. Ass'n,* 327 Ill. App. 645, 65 N.E. (2d) 31 (App. Ct. Ill.); *Vickers v. K. & W. V. R. Co.,* 64 W. Va. 474, 63 S.E. 367 (S. Ct. W. Va.), and *Miller v. Southern Pacific Co.,* 20 Or. 285 (S. Ct. Or.), the existence of an employer-employee relationship between the parties was admitted. These cases are merely illustrative of the absolute common-law duty imposed upon a master to furnish his own servants a reasonably safe place to work. A determination that an employer is burdened with such an obligation does not bear upon the question of the relationship giving rise to that duty.

Similarly in *N. Y. N. H. & H. R. Co. v. Bezue,* 284 U.S. 415, 52 S. Ct. 205, 76 L. Ed. 370; *Shanks v. D. L. & W. R. Co.,* 239 U.S. 556, 36 S. Ct. 188, 60 L. Ed. 436; *C. & E. I. R. Co. v. Industrial Commission,* 284 U.S. 296, 52 S. Ct. 151, 76 L. Ed. 304; *D. L. & W. R. Co. v. Yurkonis,* 238 U.S. 439, 35 S. Ct. 902, 59 L. Ed. 1397; *C. B. & Q. R. Co. v. Harrington,* 241 U.S. 177, 36 S. Ct. 517, 60 L. Ed. 941; *N. Y. C. R. R. Co. v. White,* 243 U.S. 188, 37 S. Ct. 247, 61 L. Ed. 667; *Industrial Accident Commission v. Davis,* 259 U.S. 182, 42 S. Ct. 489, 66 L. Ed. 888; *Pedersen v. D. L. & W. R. Co.,* 229 U.S. 146, 33 S. Ct. 648, 57 L. Ed. 1125, and in *Kamboris v. O.-W. R. & N. Co.,* 75 Or. 358, 146 P. 1097 (S. Ct. Or.), there was an admitted employer-employee relationship between the parties. The question before the court in these cases, all decided prior to the 1939 amendment to Section 1 of the F.E.L.A. (53 Stat. 1404), was whether at the time of injury the plaintiff was engaged in interstate transportation or work so closely related thereto as to be practically a part of it. Incidentally, the record herein contains a stipulation of the parties that such decisions do not bear on the basic issue in this case (Tr. 10).

II. Cases Where Negligence of Fellow-Servant Was a Valid Defense.

Cases such as *Sullivan v. Hannibal & St. Joseph R. Co.,* 107 Mo. 66, 17 S.W. 748 (S. Ct. Mo.); *C. & A. R. R. Co. v. Maroney,* 170 Ill. 520, 48 N.E. 953 (S. Ct. Ill.); *Gann v. Railroad Co.,* 101 Tenn. 380, 47 S.W. 493 (S.

Ct. Tenn.); *Ell v. Northern Pacific R. R. Co.,* 1 N.D. 336, 48 N.W. 222 (S. Ct. N.D.); *Willis v. O.-W. R. & N. Co.,* 11 Or. 257, 4 P. 121 (S. Ct. Or.); *Bloyd v. Railway Company,* 58 Ark. 66, 22 S.W. 1089 (S. Ct. Ark.); *Hough v. T. & P. Ry. Co.,* 100 U.S. 213, 25 L. Ed. 612; *Baltimore & Ohio R. R. Co. v. Baugh,* 149 U.S. 368, 13 S. Ct. 914, 37 L. Ed. 772, and *Northern Pacific Ry. Co. v. Herbert,* 116 U.S. 642, 29 L. Ed. 775, are also clearly irrelevant. They are all obsolete cases in which the defense of a fellow servant's negligence was asserted as a bar to recovery in suits where the relationship of employer-employee was conceded. The principle of law that these common law "fellow servant" and "vice-principal" theories cannot be applied in actions under the F.E.L.A. is too clear to require citation of authority. The contention that Gilpin was in effect an agent or vice-principal, because appellee retained complete and absolute control of the work, is directly refuted by the unchallenged findings of fact.

III. Nondelegable Duties to the Public.

In such cited cases as *Washington & Baltimore R. Co. v. Hahn,* 9 Sadler 364, 12 Atl. 479 (Super. Ct. Pa.); *Philadelphia B. & W. R. Co. v. Karr,* 38 App. D.C. 193 (Ct. of App. D.C.); *Lesher Wabash Navigation Co.,* 14 Ill. 84 (S. Ct. Ill.); *Venuto v. Robinson,* 118 F. (2d) 679 (C.A. 3), and *Kemp v. Creston Transfer Co.,* 70 F. Supp. 521 (D.C. Iowa), a theory of nondelegable duty was invoked by the courts to prevent the avoidance of liability to members of the public where the defendant

was engaged in the performance of business authorized by franchise. The underlying policy behind this rule as applied to members of the public is found in the fact that the public is not bound to know the relation existing between a company performing services for the public under franchise and its servants. (See cases collected, 28 A.L.R. 122-197).

Yet, the leading case of *Bibb's Adm'r v. Railroad Co.,* 87 Va. 711, 14 S.E. 163 (S. Ct. App. Va.), holds that this principle has no application where the plaintiff is employed by an independent contractor. In that case, a contractor named Smith was reconstructing a bridge for the railroad and employed Bibb on the job. One day a heavy train approached the bridge under construction and halted. Smith's foreman signalled that it might proceed. It did, the bridge broke and Bibb was killed. In an exhaustive opinion which reviews all the English and American authorities on the subject, the court denied a right of recovery against the railroad and held that the negligence of the contractor could not be imputed to the railroad.

Appellant places reliance upon a later decision by the same court in *Atlantic Coast Line R. Co. v. Treadway's Adm'x,* 120 Va. 735, 93 S.E. 560 (S. Ct. App. Va.), cert. den. 245 U.S. 760, 38 S. Ct. 191, 62 L. Ed. 540. There it was held that the duties of operating signals and keeping a special signal light which served the operation of the defendant's trains exclusively were non-assignable, in the sense that a switch tender paid by another carrier with whom defendant had a contract

for the maintenance of a railroad cross-over was an employee *pro hac vice* while engaged in performing these duties for the defendant. Therefore, the right to sue under the F.E.L.A. was sustained. In the *Treadway's Adm'x* case, the court distinguished the *Bibb's Adm'r* decision and held that it rested upon the principle that the responsibility of reconstructing a railroad bridge there delegated to the independent contractor was assignable, in so far as the railroad's liability to the employees of the negligent contractor was concerned.

The controlling authority on the application of this theory to F.E.L.A. cases is *Robinson v. Baltimore & Ohio R. Co.,* where Mr. Justice Hughes wrote (35 S. Ct. at p. 493):

> "It will be observed that the question is not whether the railroad company, by virtue of its duty to passengers, of which it cannot divest itself by any arrangement with a sleeping car company, would not be liable for the negligence of a sleeping car porter in matters involving the passenger's safety (*Pennsylvania Co. v. Roy,* 102 U.S. 451). Nor are we here concerned with the measure of the obligation of the railroad company, in the absence of special contract, to one in the plaintiff's situation by reason of the fact that he was lawfully on the train, although not a passenger. The inquiry rather is whether the plaintiff comes within the statutory description; that is, whether, upon the facts disclosed in the record, it can be said that within the sense of the act the plaintiff was an employee of the railroad company, or whether he is not to be regarded as outside that description, being, in truth, on the train simply in the character of a servant of another master by whom he was hired, directed and paid, and at whose will he was to be continued in service or discharged."

IV. Loaned Servant Cases.

Decisions involving the "loaned servant" doctrine have no application to this case, in view of the trial court's findings that appellant was acting under Gilpin's exclusive direction and control, and that Gilpin had unrestrained power to and did direct the manner and method of the work (Tr. 13-14). Cases cited by appellant which fall into this category include *The Standard Oil Company v. Anderson,* 212 U.S. 215, 29 S. Ct. 252, 53 L. Ed. 480, and *Linstead v. C. & O. Ry. Co.,* 276 U.S. 28, 48 S. Ct. 241, 72 L. Ed. 453. These cases support the established proposition of law that where one person lends his employee to another for a certain work, the performance of which is subject to the exclusive control of the other, the loaned servant becomes *pro hac vice* the employee of the borrowing employer. The Sixth Circuit case of *Cimorelli v. New York Central R. Co.,* 148 F. (2d) 575, and the two subsequent cases in the same circuit following it, *Roth v. Pennsylvania R. Co.,* 163 F. (2d) 161, cert. den. 332 U.S. 830, 68 S. Ct. 208, 92 L. Ed. 404, and *Pennsylvania R. Co. v. Barlion,* 172 F. (2d) 710, are governed by this principle. In these three cases, the court found that the work committed to the contractor involved many interdependent details of railroad operating procedure, and that the control of any one of these details could not be surrendered without disorganization of the whole. Thus, the contractor and its employees were necessarily subject to the railroad's control in the method and manner of doing their work. From these facts, the court concluded that the contractor's employees while engaged in the work were

pro hac vice employees of the railroad under the doctrine of *Singer Mfg. Co. v. Rahn,* 132 U.S. 518, 10 S. Ct. 175, 33 L. Ed. 440, and the *Anderson* case. In *Gaulden v. Southern Pacific Company,* 78 F. Supp. 651, aff'd 174 F. (2d) 1022, Judge Goodman pointed out the decisive feature of these cases:

> " * * * that substantial degree of control over the manner and means of performance as was present in Pennsylvania R. R. Co. v. Roth and like cases."

V. Cases Under the Federal Safety Appliance Act (45 U.S.C.A., Secs. 1-46).

There is no analogy between such cases as *Brady v. Terminal R. R. Ass'n,* 303 U.S. 10, 58 S. Ct. 426, 82 L. Ed. 615; *Fairport, P. & E. R. R. Co. v. Meredith,* 292 U.S. 589, 54 S. Ct. 826, 78 L. Ed. 1446; and *Louisville & Nashville R. Co. v. Layton,* 243 U.S. 617, 37 S. Ct. 456, 61 L. Ed. 931, and the case at bar. These decisions merely stand for the proposition that a violation of the Federal Safety Appliance Act may be a breach of duty on the part of the railroad creating liability in favor of other classes of persons than employees.

VI. Duty Owed to Invitee on Railroad Premises.

The fundamental weakness of appellant's position is strikingly illustrated by his reliance upon *Michelsen v. Erie R. R. Co.,* 106 N.J.L. 147, 147 A. 535 (Ct. of E. & A. N.J.). In that case, a recovery was allowed against the railroad for its failure to discover patently defective

stakes which supported a load of logs on a car delivered to a consignee. The court held that the railroad owed the consignee's employee a duty of exercising reasonable care in its inspection of the car. It was not an action under the F.E.L.A., but merely a so-called "third-party action" by the widow of a business invitee to whom the railroad owed a common-law duty of exercising reasonable care. Whether appellant, as a Gilpin employee, could maintain a common-law action against appellee on account of Gilpin's alleged negligent acts, is a question which is not before this Court. (Compare *Kelly v. Delaware River Joint Commission,* 85 F. Supp. 15 (D.C. Pa.), with *Kelly v. Philadelphia Transp. Co.,* 363 Pa. 490, 70 A. (2d) 288 (S. Ct. Pa.); and see *Pritt v. Terminal R. R. Ass'n of St. Louis,* 359 Mo. 896, 224 S.W. (2d) 119 (S. Ct. Mo.)).

VII. Violation of Section 5 of the F.E.L.A.

Appellant's reliance on *Erie Railroad Co. v. Margue,* 23 F. (2d) 664 (C.A. 6), is clearly misplaced. In that case, the court held that the defendant railroad's contract with a construction company for the maintenance of its right of way was void under section 5 of the F.E. L.A. The fact that the contract provided that the construction company was to comply with the state compensation laws, and that the construction company was largely organized and controlled by former employees of the defendant, were some of the special circumstances leading the court to find that the contract was entered into for the purpose of, and with the intent of, evading liability under the statute. As pointed out

above, the most recent decision of the Court of Appeals for the Sixth Circuit in *Jones v. New York Central R. Co.,* (supra) indicates that only when special circumstances of that kind are present is a court justified in disregarding the separate legal entity of the contractor. The findings of fact disclose the absence of such circumstances in the case at bar. Here the district court found that the contract between appellee and Gilpin "was not designed or extended as, and in fact was not, a scheme or artifice to evade the provisions of the Federal Employers' Liability Act" (Tr. 13).

VIII. Cases Under the Jones Act (46 U.S.C.A., Sec. 688) Accord with F.E.L.A. Decisions.

Appellant's position is not supported by the United States Supreme Court case of *Seas Shipping Co. v. Sieracki,* 328 U.S. 85, 66 S. Ct. 872, 90 L. Ed. 1099, followed by this Court in *United States v. Arrow Stevedoring Co.,* 175 F. (2d) 329. These cases were not brought under the "Jones Act" (46 U.S.C.A., Sec. 688), which extends the benefits of the F.E.L.A. to seamen injured in the course of their employment. Indeed, in the *Sieracki* case, it was conceded that the Jones Act did not apply because plaintiff's suit was not against his employer (57 F. Supp. 724, 726). The same contention made here by appellant was rejected in *Continental Cas. Co. v. Thorden Line,* 186 F. (2d) 992 (C.A. 4). In affirming the dismissal of a suit under the Jones Act brought in the right of a deceased employee of a contracting stevedore company against a ship operator, the Court of Appeals for the Fourth Circuit held that the

extension of the obligation of seaworthiness to longshoremen by the *Sieracki* case " * * * does not abrogate the rule that the Jones Act only applies where the relationship of employer and employee exists." (186 F. (2d) at p. 995).

It is well established in this Court, as elsewhere, that an injured seaman is granted a cause of action by the Jones Act only against one as to whom he occupies the conventional relationship of employee (*The Norland,* 101 F. (2d) 967 (C.A. 9)). This Court has held that a seaman employed by a demise charterer may not maintain an action under the Jones Act against the owner of a vessel on which he is injured (*Callan v. Cope,* 165 F. (2d) 703 (C.A. 9); cf. *Cosmopolitan Shipping Co. v. McAllister,* 337 U.S. 783, 69 S. Ct. 1317, 93 L. Ed. 1692). Thus the same principles govern the determination of the employer-employee relationship in Jones Act cases as in actions brought under the F.E.L.A.

CONCLUSION

Appellant asks this Court to extend to him the coverage and beneficial provisions of the F.E.L.A., even though following this accident he applied for and received, as an employee of Gilpin Construction Company, medical, rehabilitation and conpensation benefits provided by the Workmen's Compensation Act of the State of Oregon (Tr. 14). Under these circumstances, Judge Goodman's rule of F.E.L.A. construction adopted by this Court in the *Gaulden* case is very persuasive (78 F. Supp. at pp. 656-657):

> "The remedial and humanitarian purposes of the Employers' Liability Act in no way compel an interpretation of the contract in favor of an employment or agency relationship. It is not amiss to point out that plaintiff is not without redress for his injuries. The benefits of the Workmen's Compensation Act of California are available to him. It is not for the courts to extend the coverage of the Liability Act into new fields. During the 40 year life of the Employers' Liability Act, Congress, while liberalizing its benefits, has not seen fit to extend the scope of the statute beyond railroading in its true sense."

The district court's findings of fact are clear and unchallenged. They fully support the judgment under the uniform and well-established decisions of this Court and of other federal and state appellate courts. Therefore, the judgment appealed from should be affirmed.

Respectfully submitted,

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No. 12889

United States Court of Appeals

for the Ninth Circuit.

GENERAL ACCIDENT FIRE AND LIFE ASSURANCE CORPORATION, LTD., a Corporation,

Appellant,

vs.

VIKING AUTOMATIC SPRINKLER COMPANY, a Corporation,

Appellee.

Transcript of Record

Appeals from the United States District Court, Northern District of California, Southern Division.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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In the District Court of the United States, in and for the Northern District of California, Southern Division

No. 29779

GENERAL ACCIDENT FIRE AND LIFE ASSURANCE CORPORATION, LTD., a Corporation,

Plaintiff,

vs.

VIKING AUTOMATIC SPRINKLER COMPANY, RED AND BLUE COMPANY, a Corporation; BLACK AND WHITE COMPANY, a Co-partnership; FIRST DOE, SECOND DOE,

Defendants.

COMPLAINT FOR DAMAGES

Comes now the plaintiff above named, and for cause of action against defendants complains and alleges:

I.

The plaintiff does not know the true names of the defendants sued herein as Red and Blue Company, a corporation, and Black and White Company, a co-partnership, First Doe and Second Doe; that said defendants are sued herein by fictitious names, and plaintiff prays leave to insert their true names when the same are ascertained.

II.

That at all times herein mentioned plaintiff is a

corporation organized under the laws of the United Kingdom of Great Britain and Scotland and is a resident of said Kingdom and is authorized to and is doing business in the State of California, engaged in the business of writing and issuing policies of public liability insurance; that at all times herein mentioned The Austin Company was and is a corporation authorized to do and doing business in the State of California; that at all times herein mentioned the defendant, Viking Automatic Sprinkler Company, was a corporation organized and existing under the laws of the State of California and was authorized to do and is doing business in the Northern District of the State of California.

III.

That prior to the 23rd day of July, 1946, plaintiff issued a policy of public liability insurance, by the terms of which it promised and agreed to indemnify The Austin Company against liability for personal injuries incurred during the course of certain construction operations then being conducted and to be conducted by The Austin Company.

IV.

That in the City of Oakland, County of Alameda, State of California, on or about the 23rd day of July, 1946, the defendants entered into a written contract with The Austin Company, whereby defendants agreed among other things to furnish to The Austin Company all labor, mechanics, material, tools, equipment, supplies and services necessary to perform all sprinkler work in connection with cer-

tain buildings then being erected by The Austin Company at San Francisco Municipal Air Port (Mills Field), in the County of San Mateo, State of California; that in said contract, defendants were designated as "vendor," and Austin Co. was designated as "buyer"; that by the terms of said contract, defendants agreed as follows:

> "Insurance—It is understood and agreed that vendor is fully covered with Public Liability, Workmen's Compensation and Property Damage insurance and agrees to protect and indemnify the Buyer against all claims for damages, law suits, etc., which may arise due to difficulties encountered while vendor is servicing this operation."

V.

That defendants entered into the execution of said contract and, in the months of June and July of 1947, defendants used certain of their employees in and about said San Francisco Municipal Air Port for the purpose of carrying into effect and executing said contract; that while said employees were so working in said months of June and July, 1947, two of them were injured at said San Francisco Municipal Air Port, as hereinafter more particularly stated; that said injuries to said employees arose out of and were connected with difficulties encountered while defendants were performing said contract and servicing said operation mentioned above.

VI.

That one Homer Taylor was an employee of said

defendants as above mentioned, and while working at said San Francisco Municipal Air Port was injured on the 11th day of June, 1947; that he subsequently brought an action in the Superior Court of the State of California, in and for the County of San Mateo, against The Austin Company, being numbered 43554, wherein he alleged that he sustained certain personal injuries as the result of the negligence of the defendant, The Austin Company, and sought damages in the sum of $50,000.00; that The Austin Company gave notice of said action and demand to defendants, and demanded the protection afforded by the terms of said contract above referred to; that defendants failed, refused and neglected to protect The Austin Company from said claim or demand; that under the terms of the policy of public liability insurance hereinabove mentioned, plaintiff was required to and did defend said action for and on behalf of The Austin Company; that in order to minimize further damages and losses, plaintiff settled said claim and paid to said Homer Taylor and to the Pacific Indemnity Company (a workmen's compensation insurance company that had paid certain industrial benefits to said Taylor) the sum of $4400.00; that said sum so paid to said Homer Taylor by plaintiff was and is less than the sum claimed by said Homer Taylor and was and is a reasonable settlement of the claim of said Homer Taylor; that in addition thereto, plaintiff incurred and paid the sum of $368.51 attorneys' fees in the defense of said action, which said sum is fair and

reasonable; all to the damage of plaintiff in the sum of $4,768.51.

VII.

That one Daniel Estrada was an employee of said defendants as above mentioned, and while working at said San Francisco Municipal Air Port was injured on the 28th day of July, 1947; that he subsequently brought an action in the Superior Court of the State of California, in and for the County of San Mateo, against The Austin Company, being numbered 43853, wherein he alleged that he sustained certain personal injuries as the result of the negligence of the defendant, The Austin Company, and sought damages in the sum of $100,000.00; that The Austin Company gave notice of said action and demand to defendants, and demanded the protection afforded by the terms of said contract above referred to; that defendants failed, refused and neglected to protect The Austin Company from said claim or demand; that under the terms of the policy of public liability insurance hereinabove mentioned, plaintiff was required to and did defend said action for and on behalf of The Austin Company; that said Daniel Estrada prosecuted said action to a final judgment against The Austin Company in the sum of $12,679.70, principal and cost; that plaintiff paid to said Daniel Estrada said sum of $12,679.70 in full satisfaction of said judgment; that in addition thereto, plaintiff incurred and paid the sum of $987.09 attorneys' fees in the defense of said action, which said sum is fair and reasonable; all to the damage of plaintiff in the sum of $13,666.79.

VIII.

That plaintiff has incurred an expense in the preparation of its claim against defendants in the way of attorneys' fees, and will incur other and additional expense for services of attorneys in the prosecution of this action; and the sum of $3,000.00 is a reasonable sum to be allowed as their attorneys' fees herein.

IX.

That as direct and proximate result of the foregoing, plaintiff is damaged in the sum of $21,435.30.

X.

That demand has been made by plaintiff upon said defendants for said amounts, but defendants have refused, and still refuse, to pay said amounts to plaintiff.

Wherefore, plaintiff prays judgment against defendants for the sum of $21,435.30, and costs of suit herein incurred, interest, and other and further relief as it may be entitled to.

HEALY AND WALCOM,

/s/ HEALY AND WALCOM,
Attorneys for Plaintiff.

State of California,
City and County of San Francisco—ss.

Harry Hutchinson, being first duly sworn, deposes and says:

That he is an officer of the plaintiff General Accident Fire and Life Assurance Corporation, Ltd., a

corporation, to wit: its Principal Representative and Branch Manager for Northern California; that as such, he is authorized to verify the foregoing Complaint for Damages on behalf of said plaintiff; that he has read the same and knows the contents thereof; that the same is true of his own knowledge, except as to the matters therein stated on information and belief and as to those matters, that he believes it to be true.

/s/ HARRY HUTCHINSON.

Subscribed and sworn to before me this 25th day of May, 1950.

[Seal] /s/ AGNES M. COLE,

Notary Public in and for the City and County of San Francisco, State of California.

My Commission Expires August 28, 1951.

[Endorsed]: Filed May 25, 1950.

[Title of District Court and Cause.]

NOTICE OF MOTION

To the Plaintiff, General Accident Fire and Life Assurance Corporation, Ltd., a Corporation, and to Healy and Walcom, Its Attorneys:

Please take notice that the undersigned will, on the 17th day of July, 1950, at the hour of 10:00 o'clock a.m., or as soon thereafter as counsel can be heard before the above-entitled court, The United States Courts & Post Office Building, 7th and Mis-

sion Streets, San Francisco, California, move the above-entitled court for an Order dismissing the complaint of plaintiff on file herein on the following grounds:

1. That the complaint fails to state a claim against defendant upon which relief can be granted.

BOYD, TAYLOR & REYNOLDS,

By /s/ ROBERT F. REYNOLDS,

Attorneys for Defendant, Viking Automatic Sprinkler Company.

Memorandum of Points and Authorities

Rules of Civil Procedure for the District Courts of the United States, Rule 12 (d).

175 A.L.R. pps 29-36 inclusive.

Receipt of copy acknowledged.

[Endorsed]: Filed July 7, 1950.

[Title of District Court and Cause.]

ORDER

As in the case of Pacific Indemnity Co. v. California Electric Works, Ltd., 29 Cal. App. (2d) 260, there appears to be a latent ambiguity in the contract provisions in issue here, requiring the taking of testimony to explain what the parties meant by said provisions and to determine whether the contract was intended to indemnify the plaintiff against

its own negligence. Defendant's motion to dismiss is therefore denied.

Dated: July 24th, 1950.

/s/ HERBERT W. ERSKINE,
U. S. District Judge.

[Endorsed]: Filed July 24, 1950.

[Title of District Court and Cause.]

ANSWER

Comes now the defendant, Viking Automatic Sprinkler Company, a corporation, and answering the Complaint on file herein, denies, admits and alleges as follows:

I.

Answering paragraph II of said Complaint, admits that the Viking Automatic Sprinkler Company was a California corporation, authorized to do and doing business in the Northern District of the State of California.

Defendant is without knowledge or information sufficient to form a belief as to the truth of the remaining allegations of said paragraph, and placing its denial on said grounds, denies the same.

II.

Answering paragraph III, said defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained

therein, and placing its denial on said grounds, denies the same.

III.

Answering paragraph IV of said Complaint, defendant admits that portion starting at line 19, with the word "That," and continuing to line 28, and up to and including the word "California."

Denies the balance of said paragraph.

IV.

Answering paragraph V, defendant admits the allegations of said paragraph, commencing with the word "That," on line 2 of said paragraph, and continuing to and including the word "stated," on line 9 of said paragraph.

Denies the balance of said paragraph.

V.

Answering paragraph VI of said Complaint, defendant admits the allegations thereof, starting with the word "That," on line 14, through and including the word "defendants" on line 24 of said paragraph.

Denies the allegations starting with the word "and," line 24 of said paragraph, through and including the word "demand" on line 27 of said paragraph.

Defendant is without information or knowledge sufficient to form a belief as to the truth of the allegations of the balance of said paragraph, and placing its denial on said grounds, denies the balance of said paragraph.

VI.

Answering paragraph VII of said Complaint, defendant admits the allegations thereof, starting with the word "That," on line 11, through and including the word "defendants" on line 21 of said paragraph.

Denies the allegations starting with the word "and," line 21 of said paragraph, through and including the word "demand," on line 24 of said paragraph.

Defendant is without information or knowledge sufficient to form a belief as to the truth of the allegations of the balance of said paragraph, and placing its denial on said grounds, denies the balance of said paragraph.

VII.

Denies the allegations of paragraphs VIII, IX and X.

VIII.

Further answering said Complaint, and as a separate, distinct and affirmative defense thereto, defendant alleges that The Austin Company was negligent and careless in and about the matters set forth in said Complaint in that they failed to use due or any care or caution for the safety of others, and that said acts of carelessness and negligence on the part of The Austin Company proximately caused the injury sustained by Homer Taylor on or about the 11th day of June, 1947, and Daniel Estrada on or about the 28th day of July, 1947; that said The Austin Company would, therefore, not be entitled

to recover for damages caused by its own negligence or wrongdoing and plaintiff, as The Austin Company's public liability insurance carrier claiming a right of subrogation, has no greater right than its insured and is, therefore, not entitled to a judgment for damages.

Wherefore, defendant Viking Automatic Sprinkler Company, a corporation, prays that plaintiff take nothing by its action, and that the same be dismissed, and that defendant be granted its costs of suit herein, and such other and further relief as the court may deem just.

BOYD, TAYLOR & REYNOLDS,
Attorneys for Defendant, Viking Automatic Sprinkler Company, a Corporation,

By /s/ ROBERT F. REYNOLDS.

State of California,
City and County of San Francisco—ss.

P. W. Diggle, being first duly sworn, deposes and says:

That he is an officer of the defendant, Viking Automatic Sprinkler Company, a corporation, to wit: its President; that as such, he is authorized to verify the foregoing Answer on behalf of said defendant; that he has read the same and knows the contents thereof; that the same is true of his own knowledge, except as to the matters therein stated on information and belief and as to those matters that he believes it to be true.

/s/ R. W. DIGGLE.

Subscribed and sworn to before me this 21st day of August, 1950.

[Seal] /s/ NINA HOLDER,
Notary Public in and for the City and County of San Francisco, State of California.

Receipt of copy acknowledged.

[Endorsed]: Filed August 24, 1950.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause came on regularly to be heard before the above-entitled Court, the Honorable Louis E. Goodman presiding with a jury, on the 15th day of January, 1951, plaintiff General Accident Fire & Life Assurance Corporation, Ltd., a corporation, appearing by its counsel Healy & Walcom by John J. Healy, Esq., and defendant Viking Automatic Sprinkler Company, a corporation, appearing by its counsel Boyd, Taylor & Reynolds, by Richard A. Boyd, Esq.;

Thereupon, oral and documentary evidence was introduced by and on behalf of the parties hereto and at the conclusion of the plaintiff's case, a Motion to Dismiss was made by the defendant and the Court having considered all of the testimony and the arguments of counsel and all of the evidence and being fully advised in the premises, now makes the following:

Findings of Fact

I.

That plaintiff, General Accident, Fire & Life Assurance Corporation, Ltd., a corporation, is now and was at all times herein concerned, a corporation duly organized under the laws of the United Kingdom of Great Britain and Scotland and is a resident of said Kingdom and is authorized to and is doing business in the State of California engaged in the business of writing and issuing policies of public liability insurance;

II.

That at all times herein concerned, The Austin Company, a corporation, was and is a corporation authorized to do and doing business in the State of California;

III.

That the Viking Automatic Sprinkler Company, a corporation, was at all times herein concerned a corporation organized and existing under the laws of the State of California, and was at all times authorized to do and was doing business in the Northern District of the State of California;

IV.

That prior to the 23rd day of July, 1946, the plaintiff issued a policy of public liability insurance by the terms of which it promised and agreed to indemnify and insure The Austin Company against liability for personal injury incurred during the course of certain construction operations conducted

in behalf of the United Air Lines by the Austin Company, as the general contractor;

V.

That in the City of Oakland, County of Alameda, State of California, on or about the 23rd day of July, 1946, the defendant entered into a written contract with The Austin Company whereby defendant agreed, among other things, to furnish to The Austin Company all labor, mechanics, tools, equipment, supplies and services necessary to perform all sprinkler work in connection with the proposed United Air Lines building at Mills Field, South San Francisco, California, on a time and material basis under which the defendant received a fee of 10% for overhead and 8% for profit based on the total sum of the cost of the work plus overhead;

VI.

That in said contract dated July 23, 1946, The Austin Company was designated as buyer and defendant was designated as vendor and that Paragraph 7 of the purchase order and contract No. 4231 provided as follows:

> "Insurance—It is understood and agreed that vendor is fully covered with public liability, workmen's compensation and property damage insurance and agrees to protect and indemnify the buyer against all claims for damages, law suits, etc., which may arise due to difficulties encountered while vendor is servicing this operation."

VII.

That one Homer Taylor was an employee of defendant and while working within the course of his employment at said Mills Field on the 11th day of June, 1947, received injury resulting from the sole negligence of The Austin Company, its agents, servants and employees; that the defendant, its agents, servants and employees, were not guilty of contributory negligence that partially contributed to the accident resulting in injury to the said Homer Taylor; that an action was filed in behalf of the said Homer Taylor against The Austin Company, that was settled by the plaintiff under the terms of the policy of public liability insurance issued to The Austin Company by payment of the total sum of $4,768.51; that in addition thereto plaintiff incurred and paid the sum of $299.59 in the investigation and defense of said action;

VIII.

That one Daniel Estrada was injured on the 28th day of July, 1947, while working within the course of his employment for the defendant at Mills Field, as the result of the sole negligence of The Austin Company, its agents, servants and employees; that the defendant, its agents, servants and employees, were not guilty of negligence proximately contributing to the happening of said accident; that following the trial of said action, a payment was made by the plaintiff under its policy of insurance with The Austin Company in satisfaction of final judgment against The Austin Company in the sum of $12,-

697.70; that plaintiff incurred and paid the sum of $1,692.44 in attorneys' fees and expenses in defending the action brought against The Austin Company by said Daniel Estrada;

IX.

That plaintiff has withdrawn and dismissed its claim for expenses in the preparation of its claim against defendants by way of attorneys' fees and additional expenses of services alleged in paragraph 8 of said Complaint;

X.

That the defense of said actions were tendered to defendant, but defendant refused to accept the same.

XI.

That demand was made by plaintiff on said defendant, prior to the filing of this action, for payment of the above amounts but defendants have refused to pay said amounts to plaintiff;

XII.

That paragraph 7 of the contract between the defendant and The Austin Company is ambiguous; that the plaintiff has failed to prove that the parties to the contract intended that the defendant indemnify the plaintiff or The Austin Company for damages resulting from the sole negligence of The Austin Company, its agents, servants and employees;

XIII.

That the provisions of the contract itself are not susceptible to an interpretation that the defendant

agreed to indemnify The Austin Company for injuries received in accidents resulting from the sole negligence of The Austin Company, its agents, servants and employees;

XIV.

That the plaintiff has failed to present facts sufficient to sustain the allegations of the complaint in this case; that there is nothing presented by way of evidence by the plaintiff in this case to prove that the defendant intended and agreed to reimburse The Austin Company for payments made in behalf of The Austin Company resulting from accidents and injuries sustained by reason of the sole negligence of The Austin Company, its agents, servants and employees;

XV.

That all of the amounts mentioned herein are and were reasonable.

From the foregoing recitation of the Findings of Fact, the Court makes the following:

Conclusions of Law

1. That the Court has jurisdiction over the parties on the subject matter.

2. That defendant's Motion to Dismiss this case is granted.

3. That the plaintiff failed to prove that the parties to the contract intended that the defendant indemnify The Austin Company for damages and costs incurred by reason of the sole negligence of

The Austin Company, its agents, servants and employees.

Let a Judgment on defendant's Motion to Dismiss be entered accordingly.

Dated this 29th day of January, 1951.

/s/ LOUIS GOODMAN,
Judge of the District Court.

Approved as to form:

/s/ HEALY & MALCOM,
Attorneys for Plaintiff.

/s/ BOYD, TAYLOR & REYNOLDS,
Attorneys for Defendants.

[Endorsed]: Filed January 29, 1951.

In the District Court of the United States, in and for the Northern District of California, Southern Division

No. 29779

GENERAL ACCIDENT FIRE AND LIFE ASSURANCE CORPORATION, LTD., a Corporation,

Plaintiff,

vs.

VIKING AUTOMATIC SPRINKLER COMPANY, et al.,

Defendants.

DECREE

This cause came on regularly to be heard before the above-entitled Court, the Honorable Louis E. Goodman presiding with a jury, on the 15th day of January, 1951, plaintiff General Accident Fire & Life Assurance Corporation, Ltd., a corporation, appearing by its counsel Healy & Walcom, by John J. Healy, Esq., and defendant Viking Automatic Sprinkler Company, a corporation, appearing by its counsel Boyd, Taylor & Reynolds, by Richard A. Boyd, Esq.

Thereupon, oral and documentary evidence was introduced by and on behalf of the parties hereto and at the conclusion of the plaintiff's case, a Motion to Dismiss was made by the defendant, and the Court having considered all of the testimony and the arguments of counsel and all of the evidence, and defendant having made, signed and filed herein

its Findings of Fact and Conclusions of Law which are by reference made a part hereof, and being fully advised in the premises;

Now, Therefore, by reason of the law and evidence and the Findings of Fact and Conclusions of Law,

It Is Hereby Ordered, Adjudged and Decreed that the complaint on file herein be dismissed and that plaintiff take nothing by said complaint.

It Is Further Ordered, Adjudged and Decreed that defendant recover its taxable costs in the amount of $.......

Done this 29th day of January, 1951.

/s/ LOUIS GOODMAN,
U. S. District Judge.

[Endorsed]: Filed January 29, 1951.

Entered in Civil Docket Jan. 30, 1951.

[Title of District Court and Cause.]

NOTICE OF APPEAL TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Notice Is Hereby Given that the plaintiff General Accident Fire and Life Assurance Corporation, Ltd., a corporation, hereby appeals to the United States Court of Appeals for the Ninth Circuit from that certain decree and judgment entered in the above-entitled action on the 30th day of January, 1951.

Dated: February 27, 1951.

HEALY AND WALCOM,

/s/ JOHN J. HEALY,

Attorneys for Plaintiff.

Receipt of copy acknowledged.

[Endorsed]: Filed February 27, 1951.

In the District Court of the United States for the Northern District of California, Southern Division

No. 29779

GENERAL ACCIDENT, FIRE & LIFE ASSURANCE CORPORATION, a Corporation,

Plaintiff,

vs.

VIKING AUTOMATIC SPRINKLER COMPANY, a Corporation, et al.,

Defendants.

Before: Hon. Louis E. Goodman, Judge.

REPORTER'S TRANSCRIPT OF RECORD ON APPEAL

Monday, January 15th, 1951

Appearances:

For the Plaintiff:

MESSRS. HEALY & WALCOM, by
JOHN J. HEALY, ESQ.

For the Defendants:

MESSRS. BOYD, TAYLOR & REYNOLDS, by
RICHARD A. BOYD, ESQ.

(This cause came on regularly for trial this date. The Jury was duly impaneled and sworn to try the cause, whereupon the following proceedings were had:)

The Court: Would you care to make an opening statement in this matter?

Mr. Healy: Thank you.

Opening Statement on Behalf of the Plaintiff

Mr. Healy: May it please your Honor and members of the Jury: This case, I might say, is a little unusual, but we think rather simple.

We must keep in mind these various parties, so I will emphasize their names so that you will have them in mind.

The Austin Company is a nationwide organization that is engaged in the business of building various types of contruction, various buildings and so forth. It had a contract with the City and County of San Francisco, I believe, or perhaps it was with the United Airlines—that isn't important at the moment—to build certain hangars and buildings at Mills Field. It was general contractor on the job, and it was on that job for about a year and a half. It did not do all the work itself, but it engaged the services of what are commonly called sub-contractors to perform various functions, and the subcontractor that we are interested in [2*] here is called the Viking Company.

That is the company that is represented by Mr. Boyd, the company that is being sued here. It entered into this contract with the Viking Company

* Page numbering appearing at top of page of original Reporter's Transcript of Record.

to install a sprinkling system in these various hangars or buildings that were later to be used in the aircraft industry.

Now it entered into this contract I think it was in June of 1946, and at the time that it entered into the contract and for several months prior thereto, it, that is to say, the Austin Company, was insured under a very general policy of comprehensive liability insurance, commonly called a comprehensive liability policy, and that would, in substance, agree to pay any loss or any liability that would be imposed by law, is the way it reads—any liability that would be imposed by law upon it, the Austin Company, for any of its operations throughout the United States, including of course, this job at Mills Field.

The company that issued that policy is the plaintiff. That is the company that I represent. That is the company that this gentleman who sits to my right is the manager of, and who will be our first witness. His name is Mr. Siebold. The plaintiff is the General Accident—the exact name is General Accident, Fire & Life Assurance Corporation, Limited. It is a corporation that is organized under the laws of Great Britain, having its main office in this country in [3] Philadelphia, and it is authorized to and was doing business in California.

I have mentioned we have three parties—the General Accident, Fire & Life, the Viking Company and the Austin Company.

And the Viking Company at the time that the contract—or rather I should say sub-contract—was

entered into, this sub-contract provided as follows—and the contract will be introduced in evidence, or at least a photostat of it:

"It is understood and agreed that the vendor"—The vendor is elsewhere described in the contract as being the Viking Company, that is, the company putting in these sprinklers——

> "It is understood and agreed that the vendor is fully covered with public liability, Workmen's Compensation and property damage insurance, and it is further agreed that it agrees to protect and indemnify buyer"——

and the buyer is elsewhere referred to as the Austin Company——

> "against all claims for damages, lawsuits, etc., which may arise due to difficulties encountered while vendor is servicing this operation."

In other words, the Viking Company, which is the vendor referred to, agreed to carry liability insurance on this job and agreed to reimburse the Austin Company for any [4] loss that the Austin Company might sustain on the job due to damages, lawsuits and so forth.

Two men, workmen and employees of the Viking Company, one named Estrada, the other man's name was Taylor—were both injured on the job. One was injured when he fell down an open unguarded hole, and the other man was working and a clam bucket crane came along and the thing collapsed and he was injured. Both of those men, Estrada and Taylor, were employees of this Viking Com-

pany, that is the sprinkler company. They brought suits in San Mateo County against Austin Company. One of them was tried before a Jury.

Let me go back just one second. They brought suit against the Austin Company claiming that they were hurt because of the negligence of the Austin Company. These suits were brought in San Mateo County.

The Taylor case was settled.

The Estrada case was tried before Judge Scott and a Jury, and resulted in a verdict of $150,000 in favor of Mr. Estrada.

On a motion for a new trial——

The Court: Who was that suit brought against?

Mr. Healy: That was against Austin. I will repeat, Estrada was suing Austin.

The Court: Estrada was an employee of the Viking Company? [5]

Mr. Healy: Yes, your Honor, he was an employee of the Viking Company. These two men were employees of this Viking Company, and they sued the Austin Company claiming that they were hurt because of some dereliction upon the Austin Company. I guess they were right, because one got $15,000—I will tell you about the other one in a moment. On the motion for a new trial it was cut down to $12,500. And in stepped the plaintiff, my company, the General Accident, and paid it.

I want to withdraw that so you get the chronology of the thing.

Right after the suits were filed the Austin Company referred it to the General Accident Company,

Mr. Siebold's company, for defense, and they engaged the services of a well known firm of attorneys in San Francisco, Messrs. Bronson, Bronson & McKinnon, to represent the Austin Company.

They made demand, however, on Viking; they said, "Here, you are supposed to take care of this"; but Viking did not do anything.

The Estrada case was tried before Judge Scott and, as I said, resulted in a $15,000 verdict, was cut down to twelve thousand and there were some odd dollars costs. We have the exact checks on it.

With regard to the other gentleman, Mr. Taylor, that case did not go to Court. There was a suit filed, but it was settled for Forty-four hundred odd dollars, I think the [6] figure was. Both those amounts were paid by the General Accident Company, and also they paid incidental expenses that we will show you, checks for attorneys' fees and Court reporters and a number of little matters.

Members of the Jury, and your Honor, the whole thing in a nutshell, so to speak, is, the General Accident Company, having paid these losses—one of over $12,000 and one of $4400, plus some expenses, is seeking to get this back from the Viking Company, that had agreed under its contract to—I need not read it to you again—to protect and indemnify the Austin Company against all damages, lawsuits and so forth.

Just one further word. The General Accident Company, I believe His Honor will instruct you as a matter of law, having paid expenses in that as-

sumed, or, as we lawyers say, it is subrogated to the rights of this Austin Company.

That is the case. We intend to prove that.

His Honor asked us earlier whether there was any factual issue to be presented. Mr. Boyd will probably tell you what his contentions are. We think that is just it; that we can prove all those things, and if so, we are going to ask you for a verdict for an amount, computing all these figures together, will probably be $16,000, or more than that—sixteen or seventeen thousand dollars.

The Court: Do you wish to make your statement at this time? [7]

Mr. Boyd: Yes, if I may, your Honor.

Opening Statement on Behalf of Defendants

Mr. Boyd: May it please your Honor and ladies and gentlemen of the Jury and counsel: It is now my privilege, as attorney for the Viking Automatic Sprinkling Company, to outline for you generally our position in this case and the facts that we expect to prove, after which, after the facts are introduced by the evidence and the law is given to you by his Honor, we will request that you return a verdict in favor of the defendants in this action.

As has been indicated by his Honor and by Mr. Healy, this is a most unusual situation. My clients are engaged in the automatic sprinkler business. They install the automatic sprinklers around various buildings, new and old and in the process of construction.

Some time in 1946, the Austin Company, who are nationwide general contractors, entered into a contract with the United Airlines to construct and build the maintenance base, the various buildings and so forth, that will be described for you generally around the San Francisco Airport. And I am sure we are all familiar with that recent construction down there.

Now at the time that the general contract was started, the Austin Company did carry insurance, we assume, as has been alleged, with the General Accident, Fire & Life Assurance [8] Society or Company of Great Britain, protecting them for suits of negligence that resulted from the operation of this work down there from their own negligence.

In July of 1946 the Austin Company had some conferences with my clients' representatives relative to the construction of the sprinkler system in these new buildings that were being constructed around the airport.

Well, it so happened at that time that the Austin Company had not set out any definite plans or specifications for the installation of the sprinkler systems, so an agreement was entered into between the Viking Company and the Austin Company providing that the Austin Company would award the sprinkler job to the Viking Company on what is generally referred to as a cost-plus contract, whereby the Austin Company would pay my clients the actual cost of their labor and materials, plus an allowance for overhead expenses and an allow-

ance for profit, which was eight per cent on this particular job.

Included in that contract were certain provisions as to the operation and the work, by which the Austin Company agreed to construct all the scaffolds and they would generally supervise the work, and provided generally that when a certain part of a building was ready for a sprinkler system, we were to go in, put in the sprinkler system and would bill them for the labor and material. [9]

This contract, ladies and gentlemen, is really drawn up on three different types of forms. One is a printed form of some four pages that has been printed by the Austin Company and is used apparently on all of their jobs all over the country or wherever they operate, and that refers generally to the contractor and sub-contractor relationship and provides that we will install an automatic sprinkler system on a cost-plus basis. Then attached to that contract—and as has been indicated, these contracts will be introduced in evidence—is a multigraphed or mimeographed form that is referred to as Section A: "General conditions for sub-contractors," some of which might apply to this particular operation, some of them couldn't possibly apply. But the general multigraphed form was attached to the printed form.

And then on top of that there is what is called a purchase order, on a form that was printed by the American Sales Book Company of Niagara Falls, New York, which contains certain provisions, and refers to the buying and selling of products—

that is the vendor-buyer relationship; and in this purchase agreement attached to the printed contract, and attached to the general provisions of the multigraphed form, there are certain provisions including "Shipping notices," "Car loads," "Cartage or packages"; terms as to the payment of bills with two per cent deducted for cash if paid before the 15th of the month, and a provision that—I will read this to [10] you, "That the vendor"—that would be my client—"agrees to protect and indemnify the buyer"—that would be the Austin Company—"against all claims for damages, lawsuits, etc."—et cetera, or, and so forth, or whatever you might want to call it—"which may arise due to difficulties encountered while vendor is servicing this operation." Now that is the provision of the contract under which we have been requested to pay some $21,000 to the General Accident Fire & Life Assurance Company.

In accordance with the provisions of the contract and in accordance with the laws of the State of California, the Viking Company obtained a Workmen's Compensation insurance policy with the Pacific Indemnity Company, and in July of 1947 one of our employees, Mr. Taylor, was working under a bridge that had been constructed by the Austin Company.

The Court: Just a moment, counsel. The remainder of the Jurors need not wait; you won't be needed any further today.

Go ahead, counsel.

Mr. Boyd: Keep in mind we are in the sprinkler

system business; we are not contractors for construction. And there was a ditch that was dug by the general contractor, the Austin Company, and we put our water mains in there. So they built a bridge across this ditch. This was the Austin Company, insured by the General Accident. And the Austin Company provided [11] all heavy equipment, and they had a big crane that was used for various purposes around this job. So one of our men, Mr. Taylor, was working under this particular bridge, and without any warning or anything else they ran this crane over the bridge and mashed it down and mashed Mr. Taylor, and Mr. Taylor did file a suit against the Austin Company and he charged them with negligence. We paid, or rather Pacific Indemnity Company in our behalf, paid compensation benefits to Mr. Taylor, and after the entire matter was over, suit was filed and so forth, the General Accident, under their policy for which they received premiums from the Austin Company, did pay Pacific Indemnity Company the amount that they had paid and they made a settlement with Mr. Taylor. In other words, ladies and gentlemen, we will prove that the accident to Mr. Taylor was occasioned entirely by the negligence of the Austin Company and their employees in running a crane over a temporary bridge and mashing it down on Mr. Taylor.

Now the second man was Daniel Estrada. In July of 1947 he was working in the building constructed by the Austin Company insured by the General Accident, and in the construction of this

particular portion of the building the Austin Company had left a large hole which was a stair well, and they ultimately were going to put a stairway in this hole, and one of our employees, Estrada, fell into this hole and received injuries, and he too employed an attorney and filed a [12] suit against the Austin Company, and he alleged in his complaint that the Austin Company wilfully and negligently and carelessly—now this is Mr. Taylor; Taylor alleged that the Austin Company wilfully, negligently and carelessly caused this crane to run over the plaintiff. And that was paid.

And in the suit filed by Mr. Estrada, or in his behalf, it was alleged that the Austin Company was the general contractor and in complete charge of the construction of this building, and that they were negligent in leaving this hole without any barricades or covering or anything else, and by reason thereof Mr. Estrada was injured.

As counsel pointed out, that case was tried, and the Jury found that Mr. Estrada was entitled to damages from the Austin Company and from their insurance company, General Accident, by reason of the negligence of the Austin Company, and they awarded damages of $15,000, or whatever it was, which was paid by the General Accident, we assume.

And Taylor paid back the money that our compensation insurance company, the Pacific Indemnity Company, had paid, to which they were entitled to a lien under the law.

Now the question that we will be confronted with is, what was the intention of the parties? I

don't mean the General Accident Fire & Life Insurance Company Limited of Great Britain, Ireland or wherever it is located—what was the intention of the parties, that is the Austin Company and [13] the Viking Company, as to the interpretation of this contract?

And in that connection, ladies and gentlemen, we will prove that at the time of these accidents, the General Accident Insurance Company—I believe that was Mr. Siebold probably, this gentleman here—took these contracts and he wrote a letter to the Viking Company that I represent outlining in general the facts, and stating that

> "These accidents should be covered by you and should be taken care of by you and you should reimburse us and take over and hold us harmless,"

and so forth, and he sent that letter to the Austin Company. And Mr. Sims, their auditor, took a look at this letter and said in effect, "We wouldn't do anything like that at all." This was back in 1947.

Thereafter it appears, and we will prove by the auditor of the Austin Company, whom we have subpoenaed—we will prove that some time later, approximately eighteen months after these accidents occurred, Mr. Siebold again requested that the Austin Company write a letter to us demanding that we take over the defense and pay for these lawsuits, and we will prove that at that time, ladies and gentlemen, some eighteen months after the accidents

happened, the home office of the Austin Company in Cleveland, Ohio, said, "Well, all right, you can go ahead, because we have had trouble with the Viking Company on a job in Chicago and they wouldn't cooperate with us and [14] they wouldn't do anything about it. So you go ahead and tell the insurance company to go ahead and sue the Viking Company" or words to that effect.

Now, ladies and gentlemen, we will further prove that the Viking Company is a California Company; we know nothing of what went on in Chicago. The Viking patents are handled by various companies in various parts of the country. We have the State of California under our license. We don't know what went on in Chicago. But we will prove that the Austin Company, their local man here who negotiated this contract, wouldn't even let the General Accident go ahead and file this suit until he obtained permission, and he did not obtain permission until some eighteen months later when there was some controversy in Chicago.

Keep in mind that this is a cost-plus contract by the Austin Company, not the General Accident; that the Austin Company agreed to pay us for our expenses and to give us a profit on this particular operation of eight per cent. That was our margin of profit for putting in the sprinkler system, for using our engineering experience and our ability as contractors. All during the time and every month, or roughly once a month, these matters were brought up, what work was completed, and so forth. Every month we would go to the Austin Company and say,

"Gentlemen, we have done this, we have furnished this material, and so forth. Here are the [15] invoices; you check them with your receiving clerks," and so forth, "and figure out what we have done, and pay us what amounted to eighty-five per cent of it under the contract," as will be brought out. So this went on all this time after these accidents happened clear on through up until December of 1948, when they finally decided that we should talk these things over and we negotiated and we agreed on settlements for our materials, we agreed on everything with the Austin Company, and there was never a single word said by the Austin Company to the Viking Company about paying for these claims, paying for the attorneys' fees that were spent by the General Accident, and nothing was ever said by anyone about the Austin Company even wanting us to indemnify them against their own negligence until after an agreement was reached and the contract was all straightened out, the payments were made, everything was fine, and then the question came up as to whether or not we would indemnify the General Accident Assurance Company who took a premium for the protection of Austin Company's negligence.

Now, ladies and gentlemen, I am sure that this is a complicated issue. I hope that I haven't made it more complicated by my discussion here, but it all boils down to this: what did the parties intend? The Austin Company, not the General Accident. We know what they intended, but that has nothing to do with it. What did the Austin Company and

the [16] Viking Company intend by these words, "protect and indemnify the buyer"—not the general contractor, the buyer—"against all claims for damages, lawsuits, etc."—and so forth, etc., it says in so many words—"which may arise due to difficulties." We expect to prove, ladies and gentlemen, that we never had any intention of agreeing to go into the insurance business and assuming the liability of the Austin Company. We had no intention to take over claims resulting from their own negligence.

Mr. Healy: It strikes me counsel is arguing the case and has been for some time. I didn't want to interrupt.

The Court: I think he is through now, counsel.

Mr. Boyd: In other words, ladies and gentlemen, we did not intend and we are certain that the Austin Company did not intend that this provision under a buyer-vendor agreement printed by the American Sales Book Company of New York, Niagara Falls or some place, was not intended by the Austin Company and by the Viking Company to hold harmless and protect the Austin Company.

We will ask that after all the evidence is introduced that you will decide the case on the facts and the law as it will be given to you by his Honor, and we will ask that you return a verdict in favor of the defendant Viking Automatic Sprinkler Company. Thank you.

The Court: The Jury may take a brief recess at this [17] point. Please bear in mind that when you are absent from the Court Room it is your duty not to talk about the case among yourselves, nor are

you to let anybody else talk to you about the case, nor are you to form or express any opinion in this matter until the case is finally submitted to you, if it is. Will you take the Jury out for a brief recess, please.

(Thereupon the Jury retired from the Court Room and the following proceedings were had in the absence of the Jury:)

The Court: Gentlemen, I have heard the opening statements on both sides, and I am completely in the dark as to what possible question could be submitted to the Jury in this case. Why are we spending money for a Jury trial on a matter that is obviously solely and wholly a question of law as to the meaning of the provisions of this contract?

Mr. Healy: We did not demand a Jury.

The Court: I am not concerned with who demanded the Jury. We have got a Jury summoned here. I see no reason for incurring the expense in having the Jury sit here on a question of law, counsel. It is no concern to me who requested the Jury or whether both sides requested the Jury or not. The only question in this case obviously, on the statements that both of you have made, is whether or not under this provision of the contract this insurance company is entitled to recoup the loss which they suffered on the policy which they insured the Austin Company for liability upon the part of the Austin [18] Company; whether it can recover this amount from the defendant company under the provision of the contract the interpretation of which is a matter of law, that is all.

Mr. Healy: I thought so.

The Court: What am I going to submit to the Jury in this case? I can't say to the Jury, "Is the defendant liable?" because that means that the Jury has to say what is meant by that provision of the contract.

Mr. Healy: I would think there would be a directed verdict.

The Court: In other words, there is nothing that counsel have said that raises any issue of fact.

Mr. Boyd: As I understand the matter, if your Honor please, the intentions of the parties is a question for the Jury.

The Court: The intention of the parties doesn't arise out of any disputed question. Whatever you have said is something that couldn't possibly be disputed: that your client never at any time agreed that it would be liable for these losses and took that position.

I don't know; it seems to me offhand, that the plaintiff has a pretty heavy burden in this case. I don't know what the theory is upon which it is entitled to recover. I understand there are some similar cases cited in some California authorities to me, but I am of course not familiar [19] with what they hold. Mr. Healy, with respect to this particular provision of this contract, it seems to me that it is wholly a question of law.

Mr. Boyd: My—rather, I will say our position on the matter, if your Honor please, was that the question of intent of the parties is a question of fact for the trier of the facts.

The Court: The question of intent is a question of law. I think that what you are confused about is that it may be if there is any dispute as to the facts. There is no factual question to be resolved, and the mere fact that there may be a dispute of law as to what that means in terms of intent doesn't make it a question for the Jury. If you have a question such as "Did a certain conversation occur on a certain day?" or "Did the defendant write a certain letter?" and there is a dispute as to whether they wrote the letter or as to whether they had the conversation, then I can submit a special interrogatory to the Jury, "Did the defendant write this letter?" "Did this conversation occur on such and such a day?" But if there is no dispute as to what occurred, the question of intent is one of law. What have you said or has the plaintiff said in the opening statement that presents a question upon which the parties disagree or any dispute as to what occurred?

Mr. Healy: I have not.

The Court: He said the same thing you have said. [20]

Mr. Boyd: We haven't gone into the question of accord and satisfaction or anything of that nature up to the present time.

The Court: That also, as far as I see it, if it has any merit, is a question of law.

Now the plaintiff has not disputed or won't make any point that the parties did not settle up all their contractual affairs without any particular mention of this, unless I am in error—without mention of this insurance question. They are contending that you

are liable because of the provision of this contract; is that right?

Mr. Healy: That is right.

The Court: That is the only basis of their contention. That is the only question of law. I am rather curious, Mr. Healy, as to the legal basis for the right to recovery here.

Mr. Healy: There are two cases in California——

The Court: Not that I am prejudging it.

Mr. Healy: There are two cases in California that are squarely in point. One of them was discussed with your Honor in this case that came up here.

The Court: I knew I had heard about this question some place.

Mr. Healy: That was the De Lucci and Devencenzi and Haskins case. I represented the people, but I had nothing to do with that phase of it. I think your Honor later decided that following [21] the case of Southern Pacific Co. vs. Fellows, 22 Cal. App. (2), 87, and another case in 29 Cal. App. (2).

The Court: That is Pacific Indemnity Company against California Electric Company.

Mr. Healy: Those two seem to be right in point.

The Court: Even if they hold that you can recover and be subrogated on a claim that arises out of your own negligence——

Mr. Healy: Yes, that is right.

The Court: The question still remains as to whether under this provision of the contract, with

this provision in the contract it gives that right.

Mr. Healy: That is a law question.

The Court: That is a law question, it seems to me.

Mr. Healy: I think it is. I think, your Honor, if we prove that, as I am certain we can, I think your Honor would have to direct the Jury to render a verdict for the plaintiff, I really think so.

I can see a possible factual issue on the reasonableness of the attorneys' fees that this company paid to the Bronsons, but if Mr. Boyd and I couldn't get together on it and not take up your Honor's time and the Jury's time, it is a sad state of affairs.

The Court: It would seem to me the only question is what is the meaning of this provision in that contract? Is [22] that provision of the contract such a provision as would constitute an undertaking on the part of your company that would give rise to a liability upon the theory that these California cases go on. And that it seems to me is purely a question of law. We would have the contracts in front of us, and what the circumstances were at the time that the contracts were entered into, what kind of a transaction it was. And then we would have to say what is meant by that provision of the contract. And I would say that that presents a question that at first blush would be one that is very strongly in favor of the defendant, as to whether or not that means that they were intending to indemnify, to hold the other party to the contract

harmless from liability from any source under the contract—that may arise from any cause under the contract, which I think was the case in these California cases, wouldn't it?

Mr. Healy: Yes. The California cases are just directly in point. They are decided by separate and distinct Courts right at the same time.

The Court: Counsel, I am not asking either side to try a case before the Court in preference to a Jury; I have got plenty to do. As a matter of fact it makes no difference to me one way or the other. The parties have a right to a Jury; I am a firm believer in the Jury system; if there is any factual question I wouldn't say one word to even indicate to any side in a case that they should try that question of fact before a [23] Court rather than before a Jury, because it is their right to have a Jury and I firmly believe in that; that it is better to have a Jury if anybody has any question about it when there is a factual question. But for the life of me I can't see what is involved in this case that I could submit to the Jury. This case could be submitted to the Court; put the documents in evidence and make a statement of the facts, and the whole matter could be submitted to the Court in a few hours, whereas we would be keeping a Jury here for two or three days to listen to witnesses testifying something that isn't in dispute concerning the circumstances, or what the contract was, the parties involved, what they did under the contract. There is no question that these men were paid upon the theory that their injuries arose out of the negli-

gence of the Austin Company, otherwise they would not have been paid, of course. So it is an established fact that it was their negligence. The only question is, under this provision of the contract was there any liability on the part of the Viking Company to take up the burden of this insurance, and to pay this loss because of this provision in the contract. What question of fact can I submit to the Jury?

Mr. Boyd: It is just a question—I don't know, if your Honor please; we may be prejudging——

The Court: I will keep the Jury here if you want, but it is obvious to me that it could only be in an advisory [24] capacity. The question as to whether there is liability under this provision of the contract is the only point in dispute.

There are always factual questions in most cases, but the question is, are those factual matters pertinent and material. There may be some dispute as to what occurred on a certain day, for example, but you don't have to keep the Jury here unless that is vital to a determination of the question of the meaning of the contract. There is nothing that you have said, either of you, which would indicate to me that there is anything like that involved here. I will keep the Jury if you want and it can act in an advisory capacity on a question of fact if there is one presented at any time that has any bearing on it, but I don't think that counsel should demand a Jury if it is only in some advisory capacity, because unless it is something that vitally bears on the law question——

Mr. Healy: I am willing, your Honor, to suggest this: that the matter be submitted to your Honor on the two opening statements made and further agree that the heart of the case is the construction of that clause, and leave it to your Honor as a trier of fact and a trier of law, if there is a mixed question, should there be, to decide it, and submit it to your Honor.

The Court: I don't ask you to submit any question of fact to me where there is a Jury present.

Mr. Healy: I am willing—— [25]

The Court: We are engaging in this discussion because it has occurred to me that at this point I do not see what I could spell out in the way of a special interrogatory, for example, that I could ask the Jury to answer in this case that would have any bearing on the decision as to what that provision of the contract means.

Mr. Boyd: I take it that your Honor feels the question of intent is entirely one of law rather than of fact. Am I correct in that, sir?

The Court: The way you have stated the case, I would say that is so, because you have not stated any factual controversy. There is nothing in the way of factual controversy; there may be facts that are necessary to be found upon which to base the decision as to the intent of the parties, and those facts themselves may not be in dispute. I don't know what you have in mind. What you said to the Jury, Mr. Boyd, was that "We are going to submit to you this question and we are going to show you that the defendant did not intend by this contract—

that there was no intention under the circumstances to be bound to pay any such loss as occurred in this case.'' That is what you would argue to the Jury.

Mr. Boyd: Yes.

The Court: You don't say anything, though, that would indicate that the basis upon which you wanted the decision from the Jury was in dispute as to any question of fact. [26]

Mr. Boyd: Your Honor, of course, counsel has not challenged what the facts are. I mean, he stated his case very generally. I don't know what facts he is going to prove.

The Court: You both have stated your cases. It is just as clear, it seems to me, as the day follows the night, that all you have got here is a question, taking into account the circumstances under which the contract was executed, what does it mean? Where is there any Jury question in this case? There might be in some cases; if one of you said there was a conversation between the parties before the contract was executed and one party said, "I said to John, 'This only covers in such and such kind of cases' and John agreed with me in that" and then if we had a question as to whether or not that conversation took place that way and there was a dispute, "I said one thing and John said the other thing"; then you would have a dispute which would have to be first resolved before you could determine whether or not that conversation explains an ambiguity in the contract. But if you haven't got a dispute as to the factual matter, why, then,

there is nothing to do except to decide whether the circumstances, undisputed as they are, give rise to one or the other interpretation of the meaning of the contract.

What do you say? I am willing to take a little longer on this thing if you will tell me what particular fact, what factual matter you say is in dispute. [27]

Mr. Boyd: Well, it seems to me that the—I don't think that the contract itself can be held to be ambiguous, so it is a question of the intent. I don't know what the plaintiff is going to say the various conversations were and what went on, and so forth.

Mr. Healy: I am not going to say anything.

The Court: Apparently, as indicated by his opening statement, he is not relying on anything except the provision of the contract.

Mr. Boyd: The provision of the contract without any proof, without any evidence to explain the ambiguity or anything else?

Mr. Healy: Right.

Mr. Boyd: Then, frankly, if your Honor please, I don't know whether this procedure is proper under District Court procedure or not, but I would certainly like to make a motion for a non-suit on the opening statement.

The Court: We have no such proceeding for non-suit. You would have to make a motion to dismiss. But that would involve the same question that was presented to Judge Erskine except that the Court will have before it the actual contracts.

Mr. Healy: The whole contract.

The Court: And all of the factual matters that are at the basis of the right of recovery. Then on your question of the motion to dismiss will arise a question as to whether or [28] not that provision does give a right of relief under these facts and circumstances to the plaintiff; and if you are right about that, then you win your case on a motion to dismiss.

Mr. Boyd: I certainly feel that, in view of counsel's statement that he is going to introduce no evidence as to the intent of the parties, that certainly he has not added anything to the case.

The Court: I take it he has to present in evidence his contract of insurance. He has to present these contracts in evidence and he has to make some showing as to the nature of the damage which the insurance company has suffered, what it has paid out. He has to satisfy those allegations of the complaint, because I see some of them were not admitted. So you would have to make a showing as to what took place, then he would show the terms of his contract, and he would submit his case on the terms of his contract. Then you could make your motion to dismiss.

Mr. Boyd: Certainly if that is all he is going to do, it certainly won't take him very long to introduce the evidence.

The Court: Then maybe we had better keep the Jury on, let the plaintiff put on his evidence, and you make your motion to dismiss and we can argue it. We can do all of that today without any trouble.

Mr. Boyd: I am sure we can. [29]

The Court: Don't you think that would be a good procedure, to put in whatever evidence you want to present in the matter to sustain the allegations of the complaint, plus the prayer, and then with that evidence before us we can see whether or not a motion to dismiss would be granted. If it is denied, unless there were some kind of evidence to present that would raise a factual issue, that would be sufficient to sustain a judgment for the plaintiff; and if what you have presented does not present sufficient, then the matter would be determined on the granting of the motion for dismissal.

Mr. Healy: Yes, your Honor.

Mr. Boyd: I think that would be the proper way.

The Court: Much of this you can stipulate to, can't you, to save time?

Mr. Healy: We will show you all our files. We have brought them over.

May I offer this suggestion: It is twenty minutes to 12; if Mr. Boyd and I can perhaps sit down here for twenty minutes a lot of this could be cut away, and the Jury be asked to return at two o'clock.

The Court: You feel you maybe could do it between now and 12 o'clock? After all, what you are going to do is to go over what you have probably lined up.

Mr. Healy: I think so. [30]

Mr. Boyd: There is only one thing. I will ask you frankly, is there any question that you paid entirely on the basis of sole negligence insofar as

the Austin Company is concerned; in other words, you were indemnifying yourself against your sole negligence? I wanted to bring that out.

The Court: Of course I don't think you need that, because the insurance policy I take it will be offered, will it not?

Mr. Healy: Well, at least we would have references to it.

The Court: Then you will have to present the judgment or payment.

Mr. Healy: We have got photostatic copies of the checks.

The Court: And there isn't any question, of course—you have said that to me a moment ago—that the insurance company wouldn't have paid unless they felt that there was negligence on the part of the Austin Company.

Mr. Healy: Absolutely.

The Court: Because that is what they were insuring against, so there can't be any question as to that.

Mr. Boyd: There is no claim of negligence on the part of the Viking Company?

Mr. Healy: I think there was at one time, Mr. Boyd, but that doesn't enter into this.

Mr. Boyd: That will simplify it; that there is no [31] claim of negligence against the Viking Company, the only claim is against the Austin Company. Their payment is evidence of that.

Mr. Healy: We thought so at one time, but it doesn't enter into this.

The Court: The Reporter has been going pretty

steadily. I think maybe we will take a recess until two o'clock. Bring the Jury back. Then you can be prepared to submit what you want before the Jury, Mr. Healy.

Mr. Healy: Yes, we will try to make the effort——

The Court: Get the papers together that you want to introduce and have them all ready.

Mr. Healy: Yes, Judge.

The Court: I think that Judge Erskine's decision was quite proper. When you only have before you a motion you do not have the opportunity to evaluate some of these questions, and it is always better to get more evidenciary light on a question before deciding a motion to dismiss.

Mr. Healy: In other words he did not have the full contract; he only had one provision. If your Honor is passing on this matter as a matter of law at any stage of the game, you will have the whole contract, which should shed light on its meaning.

The Court: You have everything before you which you consider necessary to make up your mind. [32]

Mr. Healy: Yes, because Judge Erskine——

Mr. Boyd: As I understood it, for the purpose of the motion, it was stipulated that the negligence was entirely the negligence of the Austin Company, wasn't it?

Mr. Healy: I don't know if it was stipulated, but I assure you, Mr. Boyd, it was, or they wouldn't have paid it.

Mr. Boyd: As far as the motion to dismiss before Judge Erskine——

The Court: You needn't put the Jury in the box, if you will just have them stand up right there.

(At this point the Jury was brought into the Court Room.)

The Court: It is not necessary to go in the box, because I am going to dismiss you until two o'clock. I just want to be sure that the Jurors are all here.

Members of the Jury, we have been discussing some legal questions that I think will materially shorten this case, so I am going to excuse you until two o'clock. Please return at two o'clock, and bear in mind the admonition which the Court has given you.

(Whereupon an adjournment was taken until two o'clock p.m. this date.) [33]

January 15, 1951, at 2 P.M.

Mr. Healy: We have accomplished quite a bit, your Honor, Mr. Boyd and I, in discussing the case and have agreed on certain stipulations that will materially cut down the taking of testimony and evidence.

We have stipulated that a document which I hold in my hand and will hand to the Clerk and ask that it be received in evidence, is the contract between the Austin Company and the Viking Company; that it is dated July 23, 1946, and it has attached to it certain specifications; they should all be considered as one instrument.

And may I further say, your Honor, that that is a photostatic copy. Of the first two sheets we have duplicate originals, so they will ask that they be received at the same time. They are a little more legible to read.

The Court: Very well. Plaintiff's No. 1, will that be?

The Clerk: Plaintiff's Exhibit No. 1 introduced and filed in evidence.

(Whereupon contract referred to above was marked Plaintiff's Exhibit No. 1 in evidence.)

PLAINTIFF'S EXHIBIT No. 1

Purchase Order No. 4503 On Each Package and Invoice

From The Austin Company Duplicate

District or Job Office, Oakland Name of Job, U.A.L. Repair Bas

Date of Order, 7-23-46 Charge to or Work Order No. O-38

Date of Delivery, As Require

Name of Vendor, Viking Automatic Sprinkler Company
Address 580 Market Street, San Francisco 4, California

Deliver or Ship to The Austin Company, Mills Field, So. San Francisc California.
Care of United Air Lines.
Via Railroad or Truck, Your delivery.

Please Furnish Subject to Conditions Below:

Confirming

Send invoices in triplicate to The Austin Company, 618 Grand Av nue, Oakland, California, 24 hours after delivery.

Furnish all labor, mechanics, tools, equipment, supplies and servic necessary to perform all sprinkler work in connection with the propose United Air Lines Building, Mills Field, South San Francisco, Califo nia, on a time and material basis, all in accordance with the Gener Conditions for Subcontractors pages A-1 to A-6 inclusive dated 8/6/4 your proposal dated July 17, 1946, and our drawings and specificatio which will be furnished subcontractor by contractor from time to tir during the course of the job.

We require shop drawings in duplicate from subcontractor, one w be approved by contractor and returned to subcontractor, these sh

Plaintiff's Exhibit No. 1—(Continued)

drawings must contain the stamp of approval of the Board of Fire Underwriters of the Pacific. When approved shop drawing is returned to subcontractor by contractor, subcontractor will further furnish contractor four (4) shop drawings to be used in our field office.

Work is to be performed under the supervision of contractor's field superintendent at jobsite.

The following items are included in, and will serve to amplify the definition of "Cost of the Work" as covered by Article III of the attached subcontract:

1. Cut to length steel pipe at Current Crane Company's Random pipe price sheets. Subcontractor to absorb all scrap.
2. Fittings, valves and miscellaneous items at Current Crane Company Discount Sheet less pink sheet discounts.
3. Labor and engineering at subcontractor's prevailing wage rates.
4. Materials not covered in foregoing schedule at Current Wholesale prices.
5. Insurance, social security, taxes, freight, cartage, transportation and incidental expenses at cost.
6. Sprinkler Devices at list, less fifty per cent (50%).
7. No additional charge will be made for the use of subcontractors small tools. All scaffolding and heavy equipment shall be furnished by Contractor.

Only Union Labor and mechanics are to be used on this operation.

Price and Terms: The Subcontract agreement shall consist of this purchase order, the attached subcontract form, the General Conditions for Subcontractors, Pages A-1 to A-6 inclusive, dated 8/6/45, and the drawings and specifications, the terms and conditions of all of which are bound one within the other and all of which together constitute the complete agreement existing between The Austin Company (herein referred to as Contractor) and Viking Automatic Sprinkler Company (herein referred to as Subcontractor).

Accepted: VIKING AUTOMATIC SPRINKLER CO.,
By: /s/ R. W. DIGGLE.

[Cancellation Clause: Illegible on original.]

Article 5 below does not apply.

The following Conditions form a part of this Order:

1. Shipping Notice—shall be mailed as soon as Material has been forwarded, giving Order Number, Car Number and Initials, also condensed description of Material, otherwise vendor is liable to demurrage.
2. Invoice in Triplicate.
3. Car Loads—shall be loaded to minimum capacity—if not, the vendor agrees to pay the excess freight.
4. Cartage or Packages—no charge will be allowed for either.

Plaintiff's Exhibit No. 1—(Continued)

5. Terms—Bills shall be payable on the 15th of the month following shipment (if material has been received) and 2% deducted.
6. Patents—Vendor agrees to hold and save purchaser harmless from and against all and every demand or demands of any nature or kind by reason of the use of any patented invention, article or appliance, that has been or may be adopted or used in the construction of any of the material or articles called for on this Purchase Order.
7. Insurance—It is understood and agreed that vendor is fully covered with Public Liability, Workmen's Compensation and Property damage insurance and agrees to protect and indemnify the Buyer against all claims for damages, lawsuits, etc., which may arise due to difficulties encountered while vendor is servicing this operation.

THE AUSTIN COMPANY,
/s/ J. F. VIGNONE,
Purchasing Agent.

CC: Owner MLB:BJM

The Austin Company
Engineers and Builders
Cost Plus a Fee Subcontract

This Subcontract entered into this 23rd day of July, 1946, by and between The Austin Company, an Ohio Corporation of Cleveland, Ohio (hereinafter called "Contractor"), and Viking Automatic Sprinkler Company (hereinafter called "Subcontractor"), for certain work to be performed by Subcontractor in connection with construction work being, or to be performed by the Contractor for United Air Lines (hereinafter called "Owner"), at Mills Field, South San Francisco, California.

Now Therefore, it is hereby agreed by and between the parties hereto as follows:

Article I. Statement of Work

A. Subcontractor shall provide all the necessary materials and perform all of the following work, to be installed on the premises of Owner: for a complete automatic sprinkler system and fire protection system as required in accordance with "General Conditions For Subcontractors," pages A-1 to A-6 inclusive, dated 8-6-45; the specifications (sprinkler system) as called for in P.O. attached and drawings as called for in P.O. attached, which General Conditions, Specifications and Drawings are made a part of this Subcontract.

B. The total estimated cost of the work provided hereunder is to be determined later and is exclusive of Subcontractor's fee, and it is estimated that the work herein contracted for will be substantially completed on or before as required to maintain a rate of speed satisfactory to our Job Superintendent from date

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hereon. It is expressly understood that neither Contractor, Subcontractor, nor Owner guarantees the correctness of either of these estimates.

Article II. Compensation

In addition to payment for the cost of the work, as defined in Article III, Subcontractor shall receive a fee of Ten Per Cent (10%) for overhead and Eight Per Cent (8%) for profit based on the sum of the cost of the work plus overhead, which shall constitute complete compensation for the services of Subcontractor, including profit and all overhead expense.

Article III. Cost of Work

A. Contractor shall pay to Subcontractor the actual cost of the work as follows:

1. The actual cost of all materials and supplies, including transportation thereof, labor, services, power and fuel necessary for either temporary or permanent use for the benefit of the work.

2. Rental charges for machinery or equipment, whether owned by Subcontractor or rented from others, in sound and workable condition, exceeding $300.00 in value, as may be necessary for the proper and economical prosecution of the work. The rate and use of such equipment shall be approved by Contractor before commitments are made and shall in no event be higher than the rate permitted by any applicable governmental regulation, or the prevailing rates paid in the locality for similar equipment.

3. Loading and unloading at a site of the work of machinery and equipment owned or rented by Subcontractor and the cost of such minor repairs thereto as shall be less than 2% of the original cost of the equipment repaired; and the transportation thereof to the site of said work and return transportation to the point of original shipment, or equivalent mileage.

4. [Cancelled.]

5. Travel expenses of Subcontractor's supervisors reasonably and necessarily incurred to and from the work.

6. Salaries, for the time devoted to the work, of Subcontractor's superintendents, timekeepers, foremen, supervisors and other field employees. Salary schedule for such employees shall be submitted to Contractor for approval prior to assignment.

7. Premiums on bonds and insurance specifically authorized by Contractor, and fees for permits and licenses required by state and local laws.

8. Payments from his own funds made by Subcontractor under the Social Security Act, and taxes imposed by state and local authorities on Subcontractor's payrolls, and all other taxes paid on account of this Subcontract.

9. [Cancelled.]

10. Buildings, fixtures, equipment and maintenance and op-

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eration thereof, required for any necessary field office and other facilities at the site of the work, if authorized by Contractor.

11. Sales and/or use taxes applicable to materials purchased by Subcontractor on account of this Subcontract.

12. Such other items of direct cost as may be reasonably and necessarily incurred in the performance of the work hereunder.

B. The cost of the work shall not include any part of the salaries of Subcontractor's officers; general overhead expense incurred in conducting Subcontractor's main office or any regularly established branch office; interest on capital employed or on borrowed money; and federal and state taxes on income of Subcontractor.

C. Subcontractor shall obtain the most favorable discount privileges available in purchasing materials and supplies under this Subcontract, and shall pay bills and accounts rendered for such materials and supplies within the discount period allowed.

Article IV. Payments

A. Subcontractor shall furnish Contractor, on or about the tenth day of each month during the progress of the work, with an itemized statement of the actual cost, as above defined, incurred during the preceding month in connection with the work covered by this Contract, which shall be accompanied by original invoices and payrolls, and such additional copies as may be required. Within ten days after receipt of each such monthly statement, Contractor shall pay Subcontractor for all items of cost actually incurred as shown thereby. If Subcontractor's fee hereunder is on a cost plus a percentage of cost basis, Subcontractor shall also be paid on each monthly statement 85% of the amount of its fee applicable to the actual cost incurred during the preceding month. If Subcontractor's fee hereunder is a fixed fee, Subcontractor shall be paid on each monthly statement 85% of that proportion of its entire fee which the actual cost incurred during the preceding month bears to the estimated cost of all the work covered by this Subcontract.

B. Upon completion of the work and its final acceptance in writing by Contractor, Contractor shall pay Subcontractor the unpaid balance of the cost of the work due it and the balance of its fee, less any sum that may be necessary to settle any claims which Contractor may have against Subcontractor. Contractor shall accept the completed work with reasonable promptness. Prior to final payment, and as a condition thereto, Subcontractor shall furnish Contractor with a verified certificate that all bills and claims have been satisfied, except as stated therein, and a release of all claims against Owner and Contractor arising under and by virtue of this Contract.

C. 1. Subcontractor, for itself and all persons, partnerships or corporations performing labor, doing work or furnishing ma-

Plaintiff's Exhibit No. 1—(Continued)

terials, in and about the erection and construction of said work, hereby expressly waives any and all liens of every kind or nature to which it and/or they are or may be entitled under any act, statute or otherwise.

2. Subcontractor will disclose this provision of this Subcontract to all said persons, partnerships or corporations before any such labor or work is performed or material furnished and before any agreement with reference thereto is made by the Subcontractor.

Article V. Records and Audit

A. Subcontractor agrees to keep records and books of account showing the actual cost to him of all items of labor, materials, equipment and supplies, services and other expenditures of whatever nature for which payment to him is authorized under the provisions of this Subcontract.

B. Owner and Contractor shall, at all times, be afforded proper facilities for inspection of the work and shall, at all times, have access to the premises, work and materials, and to all books, records, correspondence, instructions, receipts, facilities and memoranda of every description.

C. All Subcontractor's employees shall conform to rules and regulations of Owner and Contractor on the premises.

D. Subcontractor shall conform to requirements of Owner and Contractor for records of employment, payrolls, cost distribution, purchasing, receiving of materials and other procedures.

Article VI. Purchase of Materials

A. Subcontractor shall procure Contractor's written approval before subletting any portion of the work or entering into a contract for the purchase of materials for a sum exceeding five hundred ($500.00) dollars. Subcontractor shall issue purchase orders clearly stating prices, terms, F.O.B. point of shipment and other data as required.

B. Subcontractor shall obtain at least three (3) quotations from reputable dealers in such materials, unless otherwise directed by Contractor.

C. Subcontractor shall provide evidence of the receipt of all materials used in connection with the work.

Article VII. Title to Work and Materials

As between Owner, Contractor and Subcontractor the title to all work completed or in the course of construction at the site, and the title to all machinery, equipment, materials and supplies, wherever located, and the purchase price of which is chargeable to the cost of the work, shall be in the Owner.

Article VIII. Workmanship

Subcontractor shall do the work in accordance with the drawings and specifications and in the best and most workmanlike man-

Plaintiff's Exhibit No. 1—(Continued)

ner, by qualified, careful, and efficient workers, in strict conformity with the best standard practices.

Article IX. Guarantee

Subcontractor shall repair and make good any damages or fault in said work and material that may appear within one (1) year after its completion, as the result of imperfect work done or materials furnished by Subcontractor, when certified to by Contractor as being due to one or both of these causes.

Article X. Alterations and Changes

Contractor may, by written order, issue additional instructions, require additional work or services or direct the omission of work or services covered by this Subcontract. An equitable adjustment of fee due Subcontractor will be made in accordance with the terms of this Subcontract.

Article XI. Assignment

No assignment of this Subcontract shall be made without the written consent of the Contractor.

Article XII. Insurance

Subcontractor shall, during the progress of the work maintain: (a) Workmen's Compensation Insurance for all of its employees employed at the site of the work, or if such insurance is not required by the laws of the state wherein the work is to be performed, Employer's Liability Insurance; (b) Contractor's Public Liability Insurance; and (c) Automobile Liability Insurance.

The limits of liability provided in Subcontractor's Public Liability Insurance Policy shall be $100,000.00 for injuries, including accidental death, to any one person, and subject to the same limit for each person, $200,000.00 for any one accident involving two or more persons. Such policy shall also provide for property damage liability of $10,000.00 for any one accident and subject to the same limit total aggregate liability of $50,000.00. The limits provided in Subcontractor's Automobile Liability Insurance policy shall be $100,000.00 for injuries including accidental death, to any one person, or subject to the same limit for each person, $200,000.00 for any one accident involving two or more persons. Such policy shall also provide a property damage limit of $10,000.00, covering all owned and rented equipment which is used in or on the work.

Should any part of this Contract be sublet, Subcontractor shall, in addition to the foregoing types of insurance, maintain Contractor's Protective Liability Insurance in the amount of $100,000.00 for injuries, including accidental death, to any one person, and subject to the same limit for each person, $200,000.00 for any one accident involving two or more persons, except that Contractor's Protective Liability Insurance need not be maintained to the extent that its Subcontractor maintains Workmen's

Plaintiff's Exhibit No. 1—(Continued)

Compensation, Employer's Liability Insurance and Contractor's Public Liability Insurance, and Automobile Liability Insurance, as above set forth, and provided Contractor is named as an additional insured in such policies of insurance. Certificates of all such insurance shall be furnished to Contractor.

Article XIII. Failure to Perform

If Subcontractor becomes insolvent, or if a petition in bankruptcy be filed by or against it, or if it should make a general assignment for the benefit of creditors, or if a receiver should be asked or appointed for it, or if it should refuse or fail, except in cases for which extension of time is provided, to supply enough properly skilled workmen or proper materials, or if it should fail to make prompt payment to its Subcontractors or for material or labor (except where the liens of all such parties have been effectively waived) or disregard laws, regulations, ordinances, or the instructions of the Contractor, or otherwise be guilty of a substantial violation of any provision of this Subcontract, or should Subcontractor at any time refuse to start said work promptly, or fail in any respect to prosecute the work with promptness and diligence, or if Subcontractor fail in the performance of any of the agreements herein contained, Contractor may, after twenty-four hours' written notice to Subcontractor, provide any such labor or materials, and deduct the cost thereof from any money then due or thereafter to become due to Subcontractor under this Subcontract; and at its option may terminate the employment of Subcontractor for the said work and terminate this Subcontract and may enter upon the premises and take possession for the purpose of completing the work comprehended under this Subcontract, of all materials, tools and appliances thereon, and employ any other person or persons to finish the work, and provide the materials therefor; and in any such case of such termination of Subcontract or discontinuance of the employment, Subcontractor shall not be entitled to receive any further payment under this Subcontract until the said work shall be wholly finished, at which time, if the unpaid balance of the amount to be paid under this Subcontract shall exceed the expenses incurred by Contractor in finishing the work and all other charge, expense or damage, such excess shall be paid by Contractor to Subcontractor; but if such expense and damage shall exceed such unpaid balance, Subcontractor shall pay the difference to Contractor.

Article XIV. Arbitration

A. In the event of any disagreement arising under this Subcontract between the parties hereto, it shall, upon written notice of either to the other party, be submitted to three arbitrators for decision. Each party shall choose one arbitrator within ten (10) days after receipt of such notice, the third to be chosen by the two thus selected. The decision of all or a majority of said ar-

Plaintiff's Exhibit No. 1—(Continued)

bitrators shall be final and binding upon both parties to this Subcontract. Such arbitrators' decision shall be delivered to each party in writing on or before ten (10) days after the submission of such questions to them for their decision. Each party shall pay the cost and expense of the arbitrator it selects, but the cost and expense of the third arbitrator and the remainder of the expense of the arbitration shall be borne equally by the parties to this Subcontract.

The foregoing agreement is binding upon the undersigned, their successors, executors, administrators and assigns.

In Witness Whereof, the Parties have executed this agreement in duplicate as of the day and year first above written.

VIKING AUTOMATIC SPRINKLER CO.
By R. W. DIGGLE,
Subcontractor.

THE AUSTIN COMPANY
By J. F. VIGNONE,
Contractor.

Section "A"

General Conditions for Subcontractors

The Austin Company Engineers and Builders

General Requirements

Definition of Terms

The term "Contractor" as used herein designates and refers to The Austin Company.

The term "Best" as applied to materials or workmanship means that, in the Contractor's opinion, there is no superior quality of material or finished article on the market and that there is no better class of workmanship obtainable. The terms "approved," "approved equal," etc., as applied to materials and workmanship mean specific approval by the Contractor in each particular case.

The subcontract documents consist of the Con-

Plaintiff's Exhibit No. 1—(Continued)

tractor's standard form of subcontract agreement, the drawings and specifications together with all modifications thereof incorporated therein prior to the signing. Together they form the subcontract and are complementary and what is called for by any one shall be as binding as if called for by all.

Where the initials "A.S.T.M." are used, the same shall signify "The American Society for Testing Materials."

Conditions Affecting the Work

The subcontractor shall thoroughly familiarize himself with the building site conditions and with the request for quotations, instructions to bidders, bulletins issued prior to the date for receiving proposals, form of proposals, drawings and specifications and shall ascertain shipping and delivery facilities and all matters and conditions which will affect the operation and completion of his work.

Examination of Surfaces

The Subcontractor shall examine and try all surfaces on which or against which his work is to be applied and shall notify the Contractor in writing of all that are not suitable to receive his work—otherwise the Subcontractor shall replace in a proper manner and at his own expense, any of his work which may have to be removed to correct such defects or that is damaged thereby.

Use of Premises

Materials, equipment, etc., may be stored on the premises, but the placing and handling of same shall

Plaintiff's Exhibit No. 1—(Continued)

be subjejct to the approval and direction of the Contractor.

Owner's Occupancy During Work

The Owner may occupy the adjoining buildings during the progress and execution of the work, but where necessary, in order to permit the work to be properly done, such portion will be vacated as may be required, and the equipment, stock, etc., that seriously interferes with the work will be removed by the Owner, so far as may be reasonable.

The Subcontractor, however, shall do his work in such a way as to make as little annoyance as possible, and so as not to interfere with the occupied areas of the building or its occupants, or with the continuous operation of the Owner's business.

Protections

The Subcontractor shall provide and maintain proper and sufficient protection of all his work and equipment from damage or from loss by theft; shall protect the Owner's and adjoining properties from any and all injuries arising in connection with the performance of his work; and shall make good any such damage or injury so occurring and without any expense whatsoever to the Contractor or the Owner.

Fire Insurance

The Subcontractor shall carry fire insurance on his material and equipment sufficient to protect his interests and the interests of the Contractor and the Owner as their respective interests shall appear.

Plaintiff's Exhibit No. 1—(Continued)

Workmen's Compensation and Public Liability

The Subcontractor shall comply with laws relating to Workmen's Compensation and Public Liability; shall cause his Subcontractors, if any, also to comply therewith; shall exhibit to the Contractor's satisfaction, certificates and evidence of such compliance before the work is begun; and shall continue so to comply therewith during the performance of this work.

Liens

The Subcontractor, for himself and all persons, partnerships, and corporations performing labor, doing work or furnishing materials in and about the erection and construction of his work, shall and does hereby waive any and all liens of every kind and nature to which he and/or they may be entitled under any Act, Statute or otherwise.

Co-operation of Subcontractor

The Subcontractor shall co-operate with the Contractor and with all other Subcontractors employed on the work in order to avoid complications and insure first-class workmanship in every respect, and, in the manufacturing, assembling and erection of his work.

Cutting and Patching

The Subcontractor shall consult with the Contractor and the other Subcontractors, shall leave all chases, holes or openings in his own work as may be necessary for the proper installation of their work

Plaintiff's Exhibit No. 1—(Continued)

and shall carefully fit around, repair, patch and otherwise make his work good after their work has been installed.

In case the Subcontractor fails to provide these chases, holes or openings in his work, he shall cut them afterwards and at his own expense.

Removal of Existing Work

All items of work or materials which are existing and indicated or specified to be removed or necessary to be removed for the proper installation of new work and which corresponds to the items of new work installed by the Subcontractor shall be taken down by him, and shall, unless re-used, become the property of the Owner, except where the detailed specifications direct otherwise.

Repairing and Replacing Existing Work

The Subcontractor shall repair and replace all items of existing work necessary to be removed on account of work of alterations and which correspond to the items of new work installed by him and shall leave all rooms and areas in which work of removals and alterations is done in a complete and refinished condition as far as his work is concerned.

Repairing Damaged Work

The Subcontractor shall at his own expense repair or replace all items of work damaged by him which may be due to his poor or careless workmanship.

Changes in Work

At any time before completion of the work, the

Plaintiff's Exhibit No. 1—(Continued)

Contractor may order additions, omissions or alterations to or in the work, but no such changes shall be made except by written order signed by a duly authorized representative of the Contractor in which the amount to be added to or deducted from the Subcontract price (together with additional time, if any, for the performance thereof) shall be stated.

Permits and Codes

The Subcontractor shall obtain and pay for all permits, give all legal notices, pay all fees required in connection with his work and shall comply with the Federal, State and Local Codes insofar as they apply to his work, and it is hereby agreed that those Codes are as fully a part of these Specifications as if herein repeated or hereto attached.

Subcontractor shall notify Contractor of any discrepancies between drawings and specifications, and code requirements, prior to submitting his bid, and unless otherwise instructed shall be fully responsible for obtaining approval from the proper authorities for completing the installation as shown or called for.

Contracts

Contracts awarded to Subcontractors for furnishing labor, materials and/or equipment covered by these Specifications shall be in accordance with the terms and conditions of Contractor's standard printed subcontract, a copy of which may be seen at the office of the Contractor.

Plaintiff's Exhibit No. 1—(Continued)

Trade Practices

Workmanship shall be of the highest quality throughout, in accordance with the best standard practices of the trade involved, and shall be subject to the approval of the Contractor's representative.

Only union workmen, skilled in the tasks assigned them, shall be employed.

Inspection

All work performed under Subcontract shall be subject to the inspection of the Contractor's representative, whose decisions shall be binding upon all parties.

Guarantee

All materials and workmanship furnished and installed by the Subcontractor shall be guaranteed for a period, from the date of acceptance of the work, as specified in that section of the work involved under these specifications, and as provided in the Subcontract.

Exceptions or Substitutions

Any exceptions as to materials and/or methods as included in these specifications or as shown on the drawings shall be made at the time the Subcontractor's bid is submitted; otherwise the Subcontractor shall assume full responsibility for the furnishing of the materials and/or the performance of the work as specified, and shall at his own (Subcontractor's) expense, pay for any additional costs incurred by substitutions made necessary by reason of the

Plaintiff's Exhibit No. 1—(Continued)

Subcontractor's inability to obtain specified materials.

Rules and Regulations

All work, performed under the subcontract, shall conform to all applicable laws, ordinances and regulations of all governmental bodies having jurisdiction.

Cleaning Up

From time to time or as directed by the Contractor's representative and at the completion of the work, the Subcontractor shall remove from the premises all refuse, debris, surplus material, tools, scaffolding, etc., for which he is responsible and shall leave premises in a clean, orderly and acceptable condition.

Temporary Heat

If temporary heat is required for the work before the permanent heating apparatus is available for use, the Subcontractor shall provide approved salamanders or stoves with smoke pipes to outside of building or other approved heating apparatus, shall provide adequate and proper fuel and maintain fires as required for protecting or drying out his work.

Temporary heating apparatus shall be installed and operated in such a manner that the finished work will not be damaged.

Temporary Light and Power

The Contractor will provide electric outlets located not over 100 feet apart on each floor and the

Plaintiff's Exhibit No. 1—(Continued)

Subcontractor shall provide necessary extension cords and light bulbs required for light and power in connection with his work.

Temporary Water

The Contractor will provide without cost to the Subcontractor, all water used in connection with the Subcontractor's work, and will provide hose connection at available places. The Subcontractor shall provide means of conveying water from this point to the point required.

Admitted January 15, 1951.

Mr. Healy: We have further agreed, Your Honor, that while this work was in progress at Mills Field, two employees of the Viking Company were injured and filed suits in the [34] Superior Court of the State of California in and for the County of San Mateo; and that these injuries that these men received resulted solely from the negligence of the Austin Company; that these men's names were Estrada and Taylor; and in the month of August, Mr. Estrada obtained a judgment of that Court, and in the month of October—excuse me a moment; in the month of August, 1948, he obtained a judgment in that Court of $15,000, that was reduced to $12,500 on a motion for new trial, and which was paid; and in the month of April——

The Court: That was paid by whom?

Mr. Healy: I was going to come to that in just a moment. I will read this in.

The Court: Go ahead.

Mr. Healy: And in the month of April, of 1949, a settlement was made with Mr. Taylor; that both of these men were injured while on the job there at Mills Field and within the course of their employment and, as previously stated, solely as a result of the negligence of the Austin Company; that the plaintiff herein, the General Accident Fire & Life Assurance Corporation, pursuant to its policy of public liability insurance and on behalf of its assured, the Austin Company, paid the judgment heretofore mentioned and certain other expenses and attorneys' fees and paid the settlement that I have heretofore mentioned and certain expenses and attorneys' fees, all of which are evidenced by photostatic copies of each and every [35] draft that I hold in my hands and will pass these to the Clerk and ask that they be received as one exhibit. And I will state for the record—and this is subject to correction by Mr. Siebold if it is incorrect—the total amount in the Estrada case was $14,227.31—strike that, please—$14,390.14; and the total amount in the other case, the Taylor case, was $5,068.10; that these expenses for depositions and the like and attorneys' fees were reasonable in amount.

The Clerk: Plaintiff's Exhibit No. 2 introduced and filed in evidence.

(Whereupon photostatic copies of drafts referred to above were marked Plaintiff's Exhibit No. 2 in evidence.)

Mr. Healy: That Messrs. Bronson, Bronson & McKinnon were engaged by the plaintiff herein, they being attorneys-at-law licensed to practise in this State, to represent the assured, the Austin Company, in both of these lawsuits heretofore mentioned; that Bronson, Bronson & McKinnon, at the instance of the plaintiff herein and without the knowledge of the assured, the Austin Company, on or about October 3, 1947, sent a letter, a copy of which I hold in my hand—sent a letter to the Viking Automatic Sprinkler Company demanding that they take over the defense of the Estrada action, and pointing out this paragraph 7 that forms the real basis of this suit.

I now hand to the Clerk that document and ask that that [36] be received.

The Clerk: Plaintiff's Exhibit 3 introduced and filed in evidence.

(Whereupon letter referred to above was marked Plaintiff's Exhibit No. 3 in evidence.)

Mr. Healy: That on or about January 4, 1949, the insured, Austin Company, by Mr. H. A. Sims, its district auditor, at the instance and request of the plaintiff herein, wrote a letter and mailed it to the Viking Company in similar vein to the last exhibit 3, making demand upon the Viking Company to take over the defense of the Taylor case. I now hand that to the Clerk.

The Clerk: Plaintiff's Exhibit 4 introduced and filed in evidence.

(Whereupon the letter referred to above was marked Plaintiff's Exhibit No. 4 in evidence.)

Mr. Healy: That thereafter, and after settlement was made in the Taylor case and on or about December 9, 1949, a letter was addressed from the assured Austin Company to the Viking Company calling attention that a settlement had been made with Mr. Taylor and demanding reimbursement for those amounts. I now hand a copy of that document to the Clerk.

The Clerk: Plaintiff's Exhibit 5 introduced and filed in evidence. [37]

(Whereupon letter referred to above was marked plaintiff's Exhibit No. 5 in evidence.)

Mr. Healy: That is all, Your Honor, except there is——

The Court: Is that stipulation so far made agreeable to the defendant?

Mr. Boyd: May I just make one or two observations pertaining to the stipulation?

The Court: It is not correct?

Mr. Boyd: Yes, but I want to just broaden it; as far as the negligence is concerned, I think that counsel will agree that the negligence was of the Austin Company, its agents, servants and employees; is that correct?

Mr. Healy: Yes, that is.

Mr. Boyd: The Austin Company being a corporation. Of course he stated "sole negligence," but for the purpose of the stipulation it will be understood, I take it, counsel, that there was no negli-

gence on the part of the Viking Company, its, agents, servants or employees, which contributed to the injury of either Estrada or Taylor.

The Court: Of course he said "sole negligence."

Mr. Boyd: I am sure that would cover it, but that explains its original——

The Court: Is that agreeable to you?

Mr. Healy: I will agree to that, yes.

Mr. Boyd: I also understand, counsel, that insofar as [38] this present action is concerned, in which there is a prayer for, I believe, $3,000 for your services in this action——

Mr. Healy: That is abandoned. That is abandoned.

Mr. Boyd: ——that is abandoned and eliminated from this present action.

And with those qualifications, the stipulations are accepted.

Mr. Healy: And may I state to Your Honor and to you, Mr. Boyd, that these figures and the vouchers or drafts which are in evidence, total a little more than the amount prayed for in the complaint, in that the amount prayed for in the complaint—I will withdraw that—exclusive of the attorney's fees that we sought; the point being just this: that in the complaint we only sought to recover the amounts paid to these two men plus the Court costs, plus the attorneys' fees, but there were some other matters that were later discovered such as a few items of depositions and some investigative work.

The Court: Do you wish to have the complaint amended to conform to that?

Mr. Healy: Yes, may we do that?

The Court: Is there any objection?

Mr. Boyd: No objection. I take it we now have everything in, counsel.

Mr. Healy: Yes, but there is just one more matter. Does this gentleman belong to the corporation? Is he a representative [39] that would know something? I would like to ask him a question or two.

Mr. Boyd: He is a representative, although he was not at the time, so it depends what your purpose is.

Mr. Healy: May I call the gentleman, Mr. Johnson?

The Court: Yes.

Mr. Healy: Will you take the stand, Mr. Johnson.

SAMUEL A. JOHNSON

called as a witness by the plaintiff, being first duly sworn, testified as follows:

The Clerk: Will you please state your full name to the Court and the Jury?

A. My name is Samuel A. Johnson.

Direct Examination

By Mr. Healy:

Q. Are you connected with the defendant Viking Company? A. Yes, sir.

Q. In what capacity?

A. I am an employee, an engineer.

(Testimony of Samuel A. Johnson.)

Q. Are you an officer? A. No, sir.

Q. Are you a manager?

A. Only insofar as I handle things when the manager isn't here.

Q. I will just ask you this: Are you familiar with this [40] contract that is here in evidence between the Viking Company and the Austin Company? A. Yes.

Q. And you are familiar with this paragraph 7 that we have discussed? A. Yes.

Q. I was going to ask you whether or not pursuant to the terms of that contract, your company did in fact take out public liability insurance.

Mr. Boyd: If Your Honor please, that is entirely immaterial. Objected to on that basis; no issue as to whether there is any insurance of any kind as far as its intent was concerned.

Mr. Healy: May I be heard?

The Court: I don't quite see the materiality whether they took it out or not. Their insurance company is not being sued; they are being sued.

Mr. Healy: That is right. But may I read the provision to Your Honor? It says:

> "It is understood and agreed that vendor is fully covered with public liability, workmen's compensation and property damage insurance."

It is right on the first page, right down by 7; right down in this corner of the green one. It is more legible.

The Court: All right; I have it. [41]

(Testimony of Samuel A. Johnson.)

Mr. Healy: I intend to show—I think I can show that—that that intent seems to be an essential ingredient, says Mr. Boyd—that they did in fact take out this type of insurance, and not alone that, but they had a contractual endorsement on it, so that they were well insured. If I can prove that, it would have probative value.

Mr. Boyd: If Your Honor please——

Mr. Healy: ——that they did cover this type of situation. So I think it is very material and has considerable probative value.

Mr. Boyd: If Your Honor please, there are no allegations pertaining to insurance, compensation or any other kind in this action; it is entirely immaterial. The only question that is alleged in the complaint and the only one that has been mentioned, is whether or not the agreement that has been entered into was in effect a hold-harmless agreement protecting not the insurance company, but the insured, the Austin Company, for the——

The Court: I am inclined to think that that might not be admissible, because of the fact that one might take out a public liability insurance policy to protect one against something that one might not be liable for. That sometimes happens.

Mr. Healy: Yes, but if they had a contractual endorsement on it, wouldn't it have a probative value that they realized [42] that they were exposing themselves by this contract to a contractual liability as distinguished from a tortuous liability, and paid an extra premium for it?

The Court: It might be competent if the defendant were to offer some evidence by way of rebuttal, or offer evidence on their part to that effect.

Mr. Healy: Very well.

The Court: But I don't think at this stage of the case it would be admissible.

Mr. Healy: Very well, Your Honor. With that in mind I will withdraw my question. You may step down.

Mr. Boyd: Now, may the Jury be instructed that there has been no evidence introduced?

The Court: Yes; the Jury will pay no attention to the discussions which we have just had. They concern a legal question, and there has been no evidence introduced.

Mr. Healy: We rest.

Mr. Boyd: If Your Honor please, at this time I have a matter of law which I would like to take up, if the Jury may be excused.

The Court: All right. You haven't had to listen to very much before you got another recess. Please take a brief recess, and bear in mind the admonition of the Court.

(Thereupon the Jury was excused from the Court Room.) [43]

Motion to Dismiss

Mr. Boyd: May it please Your Honor, at this time I would like to make a motion to dismiss in behalf of the defendant Viking Automatic Sprinkler Company on the grounds that the plaintiff has offered no evidence to prove either as a matter of

fact or of law that the defendant is or may be responsible for the allegations contained in the complaint. The plaintiff has, in effect, introduced what has already been determined as a contract containing ambiguous language, and the contract on its face—the entire contract having been introduced in evidence—is ambiguous and contains certain provisions in a purchase order that conflict with even other portions of the contract itself.

But confining ourselves solely to the paragraph 7 that has been referred to, we find that the wording is simply this:

> "Vendor agrees to protect and indemnify the buyer against all claims for damages, lawsuits, etc., which may arise due to difficulties encountered while vendor is servicing this operation."

Now, by stipulation we have the indisputed fact that the negligence of the insured of the plaintiff was the sole cause of the accident resulting in the injuries to Taylor and Estrada. We have a further stipulation that the negligence of the Viking Company, its agents, servants and employees, in no [44] way contributed to the happening of either of these two accidents. And we have the further stipulation, at least in effect, that the insurance company, the plaintiff in this action, did insure the Austin Company and assumed their legal liability and ultimately made payments under that policy.

It seems to be well established in all cases, and particularly in Pacific Indemnity Company vs. Cal-

ifornia Electric Works, 29 Cal. App. (2), 260, that in order to indemnify against your own negligence, it would have to be clearly and plainly stated in the agreement that the other party agreed to relieve the defendant from all liability caused by its own negligence. In that case the Court quoted with approval 31 Corpus Juris, page 450, which provides:

> "Where a person is not primarily responsible for the act or wrong which causes the injury, there is no liability on his part to indemnify the one who has paid the damages. Thus a person is not entitled to indemnity for payments made by him on a judgment against him for injuries to a third person, where it is apparent that the judgment was based on his own negligence or wrong or that of his employees."

The question has been discussed in a great number of cases, and there are quite a few cited in 175 A.L.R., 144, and we have somewhat similar language in some of those citations that we have [45] here:

> "In the 'contractor cases' the argument has been frequently advanced in defense of the strict construction rule that the interpretative inclusion of the indemnitee's own negligence under the indemnity agreement would impose upon the idemnitor a liability the extent of which would be uncertain and indefinite and entirely in the hands of the indemnitee—a liability which could not only wipe out all profit but might exceed the total consideration for the job or even the indemnitor's entire for-

tune. Stress has also been laid upon the 'hazardous' nature of the work the indemnitor is engaged in doing as a contractor or sub-contractor."

Although no evidence has been introduced and the contract has not as yet been read by Your Honor, it does cover the United Airlines construction, it is for a sprinkler system, and it is on a cost-plus basis.

There are several cases that have been cited in A.L.R. and in other digests which seem to clearly state that in order to indemnify yourself against your own negligence, there is no rule or public policy against it, although the Courts will look very carefully to see what the intentions of the parties are before they will do so; and in order to have any of these agreements hold harmless, no matter how broad they may be, and no matter what the wording is, in order to have them hold [46] and indemnify against your own negligence, it is necessary that you specifically provide in the agreement itself the intent of the parties by stating in so many words, "This agreement covers acts of liability, of negligence" and so forth.

Now assuming, as I think we will have to assume, that insofar as this particular purchase order is concerned, as I said in my opening statement, Your Honor, and I am serious about it, it was never intended to cover a contractor-sub-contractor arrangement; and it is actually a form printed by the American Sales Book Company and pertains to the

buying and selling of merchandise, and it is obvious by the conditions down at the bottom——

> "Shipping notice shall be mailed as soon as material has been forwarded"——
>
> "Invoice in triplicate"— "Carloads shall be loaded to maximum capacity—if not, the vendor agrees to pay the excess freight"—"cartage or packages—no charge will be allowed for either"—when they get——

The Court: Where do you get the fact that these forms were actually forms prepared by this Book Company?

Mr. Boyd: Right there at the bottom of the agreement. I have an original here, if I may point it out to Your Honor.

The Court: It doesn't appear on the copy. [47]

Mr. Boyd: Here it is, right down there at the bottom.

The Court: Oh, yes, I see. That doesn't appear in the copy. Of course they may have just printed this for the Austin Company.

Mr. Boyd: Well, obviously it is——

The Court: Because it does say at the top that this is the Austin Company. It may be that these stereotyped provisions were prepared by the Book Company, and then it may be that they are just in the business of doing this kind of work. It wouldn't make any difference one way or the other, because it is the Austin Company's form of contract.

Mr. Boyd: May I just point out, insofar as item 5 down there is concerned:

> "Bills shall be payable on the 15th of the month following shipment (if material has been received) and 2% deducted."

Well, now, when we get into the contract itself, that is, the printed contract between the Austin Company and the Viking Company, on page 2 of the printed contract, under the provisions as to payment we have other provisions set out, 85% to be paid when the work is completed, and so forth.

And if Your Honor will note that in the contract itself the compensation is 10% for overhead and 8% for profit based on the sum of the cost of the work plus overhead. There is no provision for any deduction for cartage, packing, hauling and [48] things of that kind. It is all included in the cost-plus contract that has been entered into between the parties.

So it seems to me, under the well established rule that we must take all of the contract and apply it together, the only reasonable interpretation of the contract would be that it was a cost-plus contract and that that purchase order was merely something that was added as something to type up a form. But in any event, limiting ourselves entirely to the provisions of paragraph 7, we have what must be considered as an ambiguous contract. Under those circumstances, by the provisions of the Civil Code and by all of the cases, the rule is that the question of interpretation of an ambiguous contract is based upon the intent of the parties.

Now, we don't have one single word of evidence as to what the parties intended.

As has been held by Judge Erskine when the motion to dismiss was brought up on the pleadings, the contract contains what I believe he referred to as a latent ambiguity, and he said in effect that it would be necessary to introduce evidence to determine the true intent of the parties, dated July 24, 1950.

The Court: Yes, I have that.

Mr. Boyd: You have that. So the plaintiff comes in here. They put the entire contract in evidence, which shows further ambiguities, and they rest their case without even [49] attempting to explain by the parties who made the contract what the intention was, not between the plaintiff and their insured, but between the Austin Company and Viking Company who are the parties that made the contract, even though in my opening statement I think I made it very clear that we denied that it was the intention of the Viking Company to ever hold harmless and protect for their own negligence. I say, in effect, they come in here and rest, introducing no evidence as to what the intention was of Mr. Sims, who is in the Court Room, or of other employees of the Austin Company who were present and entered into the agreement and made this contract.

So I submit to Your Honor that, under those circumstances, the only rules that can be applied are the general rules for the interpretation of contracts, including number 1: When a contract is prepared by a certain party such as this one is—they are printed forms by the Austin Company—and there

is ambiguity, the contract will be construed most strongly against the person causing the ambiguity.

I would like to call to Your Honor's attention two California cases as to contracts, Stein vs. Archibald, 151 Cal. 220, and Caletti vs. State, 45 Cal. App. (2) 305, holding that a contract of indemnity will not be construed to indemnify a person against his own negligence where such intent is not expressed in clear and unequivocal language.

The Court: What case are you reading [50] from?

Mr. Boyd: I am reading from an excerpt taken from those two cases, Stein vs. Archibald, 151 Cal. 220, and Caletti vs. State, 45 Cal. App. (2) 305. They are cases holding that the interpretation of contracts will be against the party who causes the ambiguity to exist. And I am sure Your Honor is familiar with the various rules as to the intent of the parties, and where you have an ambiguity the only way that you can do is to show the circumstances that surround it, and the burden of proof is on the plaintiff to prove what he intended. But in this case, insofar as this motion is concerned, at least, we do not even have an effort made by the plaintiff to carry his burden of proof and show even what he claims was the intent of the Austin Company insofar as this particular contract was concerned. So I will submit to Your Honor that——

The Court: Of course, if that were necessary to be raised as a part of the affirmative burden of proof, then the Court should permit at this time the question that Mr. Healy asked of Mr. Johnson

to be answered, if it is a part of the affirmative burden.

Mr. Boyd: I don't think that insofar as whether or not Mr. Johnson carries insurance would in any way affect in any way the meaning or interpretation——

The Court: If the plaintiff has the burden of showing the true intent of the parties, and as you have just said, he has not carried that burden, then he would have the right if [51] he could show it, if there is any evidenciary matter that might be corroborative of the intent of the defendant.

Mr. Boyd: I agree one hundred per cent that if he has any evidence that would tend to interpret or set forth the intent of the Austin Company to cover this particular situation—any evidence that he has—he not only has the right, as I see it, Your Honor, but also the duty to come forward with his evidence and show what the intent was.

The Court: But you objected to the question that he asked along that line.

Mr. Boyd: That was on the question of insurance.

The Court: Yes, but it was his contention that the fact that the defendant may have taken out insurance to cover the kind of liability that is referred to in paragraph 7 of the agreement might be evidenciary in character as to the intent with which the language in paragraph 7 was used.

Mr. Boyd: Well, I would submit, Your Honor, that the intent of the parties to any agreement should be based primarily on the intent of the man

that is making the claim that the agreement exists and it covers certain things. In other words, we have got to put the General Accident in the same shoes as the Austin Company. There has been not even a policy introduced; I assume that they have a policy and so forth; we don't know the provisions of it, but we at least cannot put them in any better position——[52]

The Court: I think in submitting the case, the plaintiff is assuming that it can have no greater rights than Austin.

Mr. Boyd: I took that assumption.

The Court: No question about that.

Mr. Boyd: Here we have the Austin Company and the Viking Company, two parties to a contract, two parties to an agreement. We have not one single word as to the circumstances surrounding the execution of the contract or their intent.

The Court: I think I understand your point. I would like to hear what Mr. Healy has to say.

Mr. Boyd: Yes, Your Honor.

Mr. Healy: Yes, Your Honor. I have these remarks to make.

I need not call to Your Honor's attention that this is a motion to dismiss, similar in form to a motion for non-suit in the State Court, and I take it the rule is well settled that you must indulge in every legitimate inference against this motion.

There is more, much more, before Your Honor than there was before Judge Erskine. For instance, the entire contract is before Your Honor. Only

paragraph 7 in haec verba was before him, and he did not read it all.

And we must not forget that the contract over on page 3, under Article XII—it is a cost plus a fee sub-contract—on page 3, Article XII three separate and distinct rather [53] long paragraphs dealing with the subject of insurance, requiring this sub-contractor to take out Workmen's Compensation and public liability insurance, setting forth what the amounts are: $100,000 for injury and death of one person, $200,000 for two or more persons, and $10,000 property damage for one accident. A detailed scheme is set up. If you construe that back with paragraph 7—and paragraph 7, as I view it, Your Honor, is in two parts—one might say there are two obligations cast upon this Viking Company under paragraph 7: One, that they are to take out insurance, three different kinds of insurance, public liability, Workmen's Compensation and property; and the other part is that they are to protect and indemify the Austin Company against all claims for damages.

Constructing all this together, certainly I make bold to say that at least there is an inference—and I am going to state it more strongly than that—but certainly there was an inference that there was to be public liability insurance taken out by this company. To cover what? To cover all losses by the buyer.

My friend Mr. Boyd has indicated to Your Honor the following propositions of law:

1. That a contract to indemnify another against his own negligence is not per se against public policy. And I agree. But he has indicated that such a contract will be [54] strictly construed. I think that is right. I think that is right.

But he has further indicated that such a contract will not be so construed unless it specifically says against one's own negligence. That is not the rule. This 22 California Appellate (2), the case of Southern Pacific against Fellows—I don't know if Your Honor has it on your desk or not——

The Court: No, I have not.

Mr. Healy: 22 California Appellate (2), at page 87, Southern Pacific against Fellows. The facts are very similar to this. I can recite them to Your Honor very quickly. The Southern Pacific was building a roundhouse.

Would it be too much trouble to ask the Clerk or Bailiff to get 22 Appellate (2) just so I can read Your Honor a sentence out of it. But if I may continue, I will state the facts very simply.

Mr. Boyd: May we also have the other case at the same time, 29 California (2)?

The Court: I have that here.

Mr. Healy: The Southern Pacific Company were building a roundhouse down south some place. They engaged the services of one Mr. Fellows as sub-contractor; they were operating as general contractor; themselves and he sub-contracted to do certain work thereunder. As I read the opinion, there was a big track running along down the building and two cranes were [55] running on that. Mr. Fellows, the

sub-contractor's, employees were operating one of these cranes. One of Mr. Fellows' men was sitting astride an iron beam near a live wire performing some work, and the Southern Pacific man was derelict in that he did not turn off the juice and the employee was severely injured and he brought suit in the United States District Court and he got a judgment for $25,000 against the Southern Pacific Company, it was affirmed and the Southern Pacific paid it. Then they took a look at their contract that they had with Mr. Fellows, which is no broader than the one before Your Honor and in which I want to call Your Honor's attention to the fact that this agreement does not say against the Southern Pacific Company's negligence; I was going to point out the very place to Your Honor there, and the Court says that such language is broad enough to cover the negligence of Mr. Fellows or the negligence of the Southern Pacific.

The Court: The provision in this Fellows case and that provision in the Pacific Indemnity case are much more specific than the provision in this case. The provision in the Fellows case is that "The contractor expressly agrees to indemnify and save the railroad harmless from and against any and all claims for losses, damage, injury and liability howsoever same may be caused,"——

Mr. Healy: That is right.

The Court: ——"resulting directly or indirectly from [56] work covered by this agreement."

Mr. Healy: That is right; I think it is stronger.

The Court: That is much stronger.

Mr. Healy: I think it is stronger. I am candid in everything I say: I think it is stronger, but I am citing now that case particularly for this, to rebut Mr. Boyd's contention that such contract is not valid unless it expressly covers the indemnitee's own negligence.

The Court: Judge York, who wrote this decision, covers it. He says,

> "The indemnity clause in the contract, undertaking, as it does, to indemnify railroad company from and against 'any and all claims, loss, damage, injury and liability howsoever the same may be caused, resulting directly or indirectly from work covered by this agreement,' is so sweeping and all-embracing in its terms that, although it does not contain an express stipulation indemnifying appellant against liability caused by its own negligence, it accomcomplishes the same purpose."

Mr. Healy: All right. Can't we say the same thing here? Is there anything broader——

The Court: You can't say the same thing here, Mr. Healy, because you haven't got that language.

Mr. Healy: Can't we say it from this standpoint: is there [57] any word in the English language more embrasive than the word "all"? That word is used right here—"agrees to protect and indemnify the buyer against all claims for damages"; it doesn't say "howsoever caused."

The Court: It says, "which may arise due to difficulties encountered while vendor is servicing this operation."

Mr. Healy: That has been stipulated to, that these fellows were within the course of their employment. That means no more than that. Certainly they wouldn't indemnify them if they were off at a dance; it means while they were on this job.

I say this to Your Honor: Mr. Boyd asked me whether or not when I said, "sole negligence," would that exclude negligence upon the part of the defendant. I said it would, Your Honor, because you can't have any more negligence than sole negligence. And I say you can't have any more claims than all claims. By the same token, sir, if it is all claims and all lawsuits, it is going to take in everybody's claims and everybody's lawsuits.

To add what was in the Fellows case, "whether caused by one or the other or howsoever caused—" I think that is the wording in the Fellows case—is, if we are going to be technical, merely redundant. If I say, "I will indemnify Austin against all claims"——

The Court: That is not the reasoning of the Appellate [58] Court of California in this Fellows case. The Judge there in writing the opinion does not reason on the basis that "all claims" was sufficient; he reasons on the basis that since the language is "howsoever the same may be caused" that that indicates an intention to in no way single out the claims as to causes at all, and he says that because he says that it is so sweeping and embrasive in its terms that although it does not contain an express stipulation of an indemnity against liability caused

by its own negligence, it accomplished the same purpose.

Mr. Healy: Well, I don't think I was saying anything contrary to Your Honor's last few remarks.

The Court: You seem to think that since it says "all claims for damages arising out of the course of the work that that is just as clear in broadening the liability on the part of the indemnitor, just as broad and all-embracing as if it did contain this more broad statement that was used in the Fellows case.

Mr. Healy: I do, sir. If I were to indemnify someone for all claims—to quote the Declaration of Independence, "All men are created equal"—that means all men——

The Court: I can follow you on circumstances where a contractor and sub-contractor engage themselves by contract and where the purpose is, of course, that the contractor shall not incur any liability by virtue of damages that might ensue [59] as a result of work done by the sub-contractor, that the sub-contractor, unless he particularly engages himself to that end, is not engaged in the business of insuring the main contractor against his own misfeasances, therefore, that being the case, more particularization would be needed in fastening that kind of liability upon the sub-contractor.

Mr. Healy: Isn't that where you get yourself into the provisions that we have right here?

The Court: If it was an insurance company whose business it is to indemnify, then you would

find the Courts, of course, extending and applying the most liberal doctrine as to liability against the insurance company, because it is the business of an insurance company to indemnify against all claims and demands. That is what it is doing; it is getting paid for the purpose of assuming that kind and type of liability, and hence the language which is used in policies that delimit liability of an insurance company are interpreted favorably to the insured. But when you have two people who are not insurers but are engaged in a different kind of activity, it would seem to me, from what I have read on this subject, that to impose upon one party to this kind of contract an insurance liability for which insurance companies get paid would be to extend the doctrine with which we are concerned here beyond the limits of reason.

While counsel says it is not against public policy to have [60] such an agreement, I think that what is meant by that is that it is not against public policy because of the fact that insurance is permitted to protect one against the consequences of his own negligence, and it could well be argued that since the State permits a man to pay for protection against his own negligence, that there would not be anything against public policy in allowing anyone to contract on that basis to protect himself against his own negligence whether it be with an insurance company or not.

But I don't think we are here concerned with any question of public policy. What is before us here

is whether under the circumstances in which this contract was written, the status of the parties, what their respective engagements were, what they were to do, the nature of their work, the nature of their relationship to one another as to whether or not by the language contained in paragraph 7 of this contract that that meant that the sub-contractor was to become an insurer of the main contractor, to protect the main contractor against the consequences of the main contractor's own negligence. That is really the whole question, and I don't think that there is any evidenciary matter that is of any consequence here except the fact that we have here two contractors; that they made this contract between them; the nature of the work in which they were engaged; what happened, how it happened, and whether or not under the circumstances that we have here that clause [61] means that the sub-contractor must indemnify the Austin Company against the consequences of its own negligence.

We can forget about the insurance company which is the plaintiff, because it merely is asserting the claim which has validity only if it could be asserted by the contractor.

Mr. Healy: Oh, yes, no doubt about that. I would like you not to be unmindful of this——

The Court: You go ahead.

Mr. Healy: I didn't mean to interrupt you; I am sorry.

The Court: You go ahead. I have read during the noon recess this case which Judge Erskine cited, and of course there he cited that case mainly be-

cause of the fact that the sole question before the Appellate Court there was whether or not the evidence was admissible to vary, to explain the meaning of a provision of the contract which was ambiguous.

Mr. Healy: And they held it was.

The Court: The Appellate Court reversed it.

Mr. Healy: No, affirmed it.

The Court: The Appellate Court affirmed the Trial Court in that instance in letting the evidence in. The Trial Judge held in the Pacific Indemnity case that the provision of that contract did not constitute an agreement to indemnify the contractor against his own negligence

Mr. Healy: In the light of the explanatory evidence.

The Court: But the Appellate Court did not pass on that [62] precise question, but merely held that the provision in the contract was ambiguous. The lower Court held that it did not bind the subcontractor, and the upper Court held that because the provision was ambiguous, it was proper to admit evidence. And on that basis, Judge Erskine, apparently feeling that this provision was ambiguous, denied the motion to dismiss on that ground. It is true, I think, that perhaps if I were deciding that motion in the same position, in the exact same position that Judge Erskine was, I would have also denied the motion to dismiss, but I would have denied it or reserved a ruling on it, on the theory that the Court ought to have more

facts than circumstances before ruling on the effect of the agreement.

And I think that is a very wise procedure to follow, because on a motion you get just what the attorneys want you to have; when you have got all of the curcumstances, you are in a position to know more about the case and perhaps make a juster ruling.

The provision in that case—I suppose you are familiar with it——

Mr. Healy: Oh, yes.

The Court: ——was even more specific than the provision in our case. I am referring now to the provision in the Pacific Indemnity case. The provision in that contract was:

> "You agree that work described herein will be [63] performed by you, and as an independent contractor and not as an employee of the company. You will indemnify and save Company harmless from and against any and all loss, damage, injury, liability, and claims therefor, including claims for injury or death to company's employees and damage to company's property and claims of liens of workmen and materialmen, howsoever caused, resulting directly or indirectly from the performance of this agreement; and will obtain and maintain in effect insurance, including Workmen's Compensation insurance, to protect Company from the above in amounts satisfactory to the Company."

There is a more comprehensive clause and still the Court held that ambiguous in that case.

Mr. Healy: There are two or three things that you must not lose sight of in that case. That is an action for declaratory relief in which the trial Court sitting without a Jury had before him the contract, and then he received extraneous evidence to shed light upon what the intent was. Then he made findings of fact and conclusions of law that it was never the intent to cover the negligence of the Standard Oil Company. Then the Standard Oil's insurer, the P. I., took it up on appeal, and their sole contention was that the trial Judge was in error in holding in this way. That is all [64] the Court was really deciding, whether or not it was permissible to bring this parol evidence in. Once they found it permissible to bring it in, they weren't going to disturb the findings of fact of the trial Judge. I think that should not be lost sight of.

The Court: That is correct.

Mr. Healy: Judge, I would like to say this, in none of these cases do we find—I don't see how we can get away from the fact in this case that this Viking Company agreed to carry insurance. Now, look; they agreed to carry insurance, and they agreed to even name, under certain circumstances—if you will look at the third paragraph of that Article XII back on page 3, they agreed under certain circumstances to name the contractor, that is the Austin Company, as an additional assured, and they also provided that certificates of all such insurance should be furnished to the contractor.

Now I am going to ask this question, to pose this question: Why is the Austin Company interested

that the Viking Company have insurance? What did they care whether they have insurance? If it is a sub-contractor they could commit all the torts in the world and Austin Company could not be responsible, could they, under the familiar rule that there is no imposition of tort liability between a sub-contractor and contractor? If they are true independent contractors—and that is what they were here—there cannot be any imposition [65] of vicarious liability. So what are they talking about insurance for here or lawsuits? Doesn't it all dovetail right back that there is a reason for it?

Your Honor said this, or maybe Mr. Boyd said it, that they took this cost-plus, a fixed fee contract. The fee was ten per cent. Can't we reasonably assume that it would have been cost-plus only eight per cent or something less, if they did not have to take this public liability insurance in rather high amounts? It costs money to carry that much insurance. If it was an ordinary contractor putting in a sprinkler system he would be willing to do the job for a little bit less if he did not have to carry public liability insurance. That isn't an unreasonable assumption. But he is bound to carry high limits, to furnish certificates of it to the contractor, to the Austin Company, and in certain instances to even name the contractor, the Austin Company, as an additional assured.

I say why? What would they care whether they had insurance or not, unless there is some meaning to it?

I ask you again not to lose sight of the fact—I

know you won't—but this is a motion for a non-suit and we have got to take this thing in the light most favorable to this plaintiff.

I could argue the law question, but I am convinced I have now covered everything——

The Court: What you have said would equally apply to the [66] contractor in its relationship to the United Airlines. The United Airlines undoubtedly required the contractor to carry public liability insurance.

Mr. Healy: They may have; I have never seen the contract.

The Court: I assume they must have. I don't suppose people enter into a contract these days without requiring the contractor to furnish public liability and compensation insurance.

Mr. Healy: Let's forget compensation.

The Court: As a matter of fact, the owner always insists upon that paragraph, as I recall it, that the contractor have that kind of insurance, and it is regarded as a part of the cost.

Mr. Healy: That may be as a practice, Judge, but we are looking at this thing from a legal standpoint. And we know that there can be no imposition of liability upon the contractor for the tort of the independent sub-contractor except under certain circumstances—non-delegable duties and the like.

Suppose some child was around or some visitor, and the Viking Company dropped a big hammer on top of his head, could the Austin Company be held for that? Certainly not. If it came into your Court

you would have to grant a non-suit against the plaintiff. [67]

Why is this Austin Company solicitous here that the Viking Company carry public liability insurance and in certain instances name them? I say because it all adds up: they intended to. This was artfully drawn; this wasn't just thrown together: "For all claims"; it can't be any more universal, and they have to carry insurance against "All claims for damages, lawsuits, etc." I don't like that "et cetera"; I say I don't like it; I don't know what it means, but I am not worried about it.

The Court: But you have to read the whole clause.

Mr. Healy: Yes.

The Court: And fairly reading the clause, you find this: that is starts out by saying that: "It is understood and agreed that vendor"—that is the Viking Company——

Mr. Healy: Yes.

The Court: ——"is fully covered with public liability, Workmen's Compensation and property damage insurance." That means, of course, that the vendor has protected itself against liability which may be against it of any nature—public liability—as it protected itself against public liability or Workmen's Compensation or property damage.

"It is understood that the vendor is fully covered"—in other words, that the vendor has protected itself; then it goes on to say: "And agrees to protect and indemnify the buyer against all claims for damages, lawsuits, etc., [68] which may

arise due to difficulties encountered while vendor is servicing the operation."

If I were the attorney for your opponent in the matter, I would argue that that provision is not ambiguous; that it is clear that what is referred to there is liabilities that are incurred by the vendor in its operations, and not by anybody else; and that it is against those failures, misfeasances and other activities of the vendor for which insurance protection is to be carried and should be carried, and that that does not mean that the kind of insurance that is spoken of there is insurance against the misfeasances or negligence of somebody else, because there is no reason arising out of the contractual relationship that anyone else except an insurance company engaged in that kind of work should engage in that kind of indemnifying arrangement.

So that it seems to me that you can read right into the clause there that what was intended that insurance should cover and the indemnification is coincident with the kind of insurance that is required to be written.

Mr. Healy: Your Honor read something here that is not there, if I may respectfully say so.

The Court: No, I am reading the whole sentence. It is all one sentence. Let's read it together.

> "It is understood and agreed that vendor is fully covered with public liability, Workmen's Compensation [69] and property damage insurance"——

Now the sentence doesn't stop there.

Mr. Healy: No.

The Court: ——"and agrees to protect and indemnify the buyer against all claims for damages, lawsuits, etc., which may arise due to difficulties encountered while vendor is servicing this operation."

Mr. Healy: Yes, but you read something else in, Your Honor, when you read it the first time when we were discussing it. Your Honor said after the words "fully covered with public liability insurance" means liability for its own dereliction. Why do you read that in? Right at that point you read that in when you were discussing it with me. Why do you say that?

The Court: Because he is the vendor under the contract. Why should that be interpreted that the vendor is protecting the main contractor? There may be a dozen sub-contractors on the job.

Mr. Boyd: There were, Your Honor.

The Court: There may be more than one main contractor on the job. Why should you read that to cover anything more than the activities in which the vendor is engaged under its own contract?

Mr. Healy: I will tell you why: Because in the very next clause, not a new sentence, this vendor is agreeing to indemnify the vendee or the Austin Company for all damages [70] against losses. Maybe I haven't explained my idea there.

The Court: If your interpretation of that is correct——

Mr. Healy: That is the way he has got it there.

The Court: ——then the clause "which may arise due to difficulties encountered while vendor is servicing this operation" would mean that, under this provision, the vendor would be liable for all damages and claims which the vendee might suffer during the period of time that the vendor was functioning under this contract, irrespective of whether they had anything to do with the vendor's contract.

Mr. Healy: Oh, no, no.

The Court: It doesn't say, "Due to the"——

Mr. Healy: Yes, it does.

The Court: It says, "Due to difficulties encountered while vendor is servicing this operation."

Mr. Healy: Yes; that is the Viking Company.

The Court: It doesn't say, "Difficulties encountered by the Viking Company."

Mr. Healy: The vendor is the Viking Company, Judge.

The Court: I am just pointing that out to you as another basis. That merely fixes the time period, that is all that does, while their contract was in effect, while the Viking Company's contract is in effect—if your analysis of the meaning of this language is correct, that during that period of time, the Viking Company would be liable for all loss and [71] damage which vendor might suffer because of any claims.

Mr. Healy: That would be an unreasonable construction. You mean if somebody else got hurt——

The Court: It is somebody else that is involved here. It isn't the Viking Company that has caused

any damage here, so if somebody else is meant by that, that is somebody else under that provision of the contract.

Mr. Healy: I think that means arising out of their servicing. It is stipulated that these fellows were employees of the Viking Company, they were working in the course of their employment, and they were hurt.

Your Honor, again I say I don't think I have made myself clear; I really don't. I don't want to labor the argument and take up too much of your time——

The Court: That is all right.

Mr. Healy: Your Honor, the way I read this thing and these provisions about insurance runs as follows: That the only reason that the Austin people, who drew all these contracts, that is true, were solicitous that there be insurance on this Viking Company—because otherwise they wouldn't care—was because they, themselves, felt that if they were negligent they could look to the Viking Company for reimbursement; but maybe the Viking Company may be defunct, in liquidation; maybe they can't do it, so they say, "You carry insurance, and you give us these certificates." [72]

Again, I say to Your Honor as a lawyer, you can't get around the fact that tortuous activities on the part of a sub-contractor will not and cannot impose liability on the Austin Company. Therefore, why would they give a hang whether they had insurance or not if it was not for the very reason I discussed?

The Court: There may be a number of reasons why they would want to do it.

Mr. Healy: For instance?

The Court: The work might be stopped and the contract might be interfered with because of the fact that the vendor here, the sub-contractor——

Mr. Healy: The State might step in?

The Court: ——was not able to complete his work, or there was difficulty against which he was not insured that might be the proper function of the main contract, and then they didn't want to be joined.

Of course, the answer to all of that is that obviously the Austin Company did not have that thought in mind, because they carry their own liability insurance to protect themselves against their own liability.

Mr. Healy: For all we know——

The Court: That is the clearest indication in the world that they did not have any such thought but they were looking to the vendor, to the subcontractor, for damages and any [73] insurance company that he might have for that damage. They just didn't have that in mind.

Of course, this is a nice thought so far as the insurance carrier is concerned, and if it can, through the medium of subrogation recoup any of what it is called upon to pay, it is perfectly proper for it to do so. But you can't do so unless the Austin Company had this right on its part. And it seems to me that that is just completely incompat-

ible with the circumstances under which this agreement was entered into and with the actions of the Austin Company itself. It had its own insurance; it had no reason to worry. It had no reason to ask a sub-contractor to protect it against the consequences of its own negligence. It already had adequate insurance covering it. That was within its own mind, that it wanted to protect against that, and there is no answer to that. It is completely at variance with the way in which a business is ordinarily conducted and these contracts are entered into.

I know there has been litigation on this very subject, because we have gotten these cases before us. And they come to us because of the ingenuity of principals and of competent lawyers trying to work out ways by which one who has suffered a loss may get some salvage on it and get it out of somebody else. That isn't an unusual procedure. And if you can do it, as the fellow says, it is nice business. if you can get it. I remember that being said when I was practicing law and I [74] remember representing some of these subrogation claims. But the question is, has the insurance company succeeded to something that was really a lawful and legal contractual right which the party insured had and which arises by virtue of a contract.

Mr. Healy: Your Honor made a remark there, that the Austin Company need not worry because they had their own insurance.

While this is outside the record, yet it may come in if the case proceeds, and I don't think—let me

put it this way: The fact of the matter is that Austin Company—I mean General Accident Insurance insures Austin Company all over the country, and I think insures them at a rate that takes into consideration these provisions. This thing all dovetails together.

The Court: I think that would be a very improvident insurance company which would base its giving insurance coverage on the theory that they might get something back by way of subrogation in this kind of a case. I understand that is true of automobile accident cases, that there is always a chance of getting something back from the other party who ran into the insured's automobile proceeding at an unlawful rate of speed at an intersection, etc., etc.

Mr. Healy: Yes.

The Court: But I don't think in contract cases that any [75] insurance company would let that enter into the calculation in fixing rates where there is general insurance issued of that nature, that they would have in mind some particular contract by which there may be a possibility of making recoupment. It might be; I don't know.

Mr. Healy: I was just going to say this, Judge: Mr. Boyd cited to Judge Erskine, 175 A.L.R. I notice you have it on the desk.

The Court: Yes.

Mr. Healy: At that time, as I pointed out to Judge Erskine, in that section that would lead one to think that a very strict rule of construction applies. Yet under subdivision G, page 144, a whole

section is devoted to the subject of Building Contractors and Subcontractors, and it would lead me to believe, from reading that, that the rule of construction is not as strict there as it is in some of these other types of relationships such as—I will just read the headnotes here——

The Court: I would think that would be so.

Mr. Healy: "Bailments, innkeepers, railroad companies, banks"——

All those are under different headings——

The Court: I would think you were right about that; perhaps it ought to be stricter in those particular cases.

Mr. Healy: It is much stricter in those cases. They [76] have innkeepers and pledgees and some others. It seems to be stricter in those other relationships than it is in the building contracts.

The Court: I wouldn't think that the decision would be made here on the basis of whether the construction should be stricter or not, but rather what is the fair and proper construction under the circumstances.

Mr. Healy: That is what it means, yes. Judge, I have said about all I can.

The Court: It is true that there are apparently a lot of cases on this question of indemnifying against the principal's own negligence.

Mr. Healy: Mr. Siebold wanted to point out something.

The Court: I will take a five minutes recess at this time.

Mr. Healy: Thank you.

The Court: If you are going to present any evidence, it couldn't take very long, could it, counsel? I am thinking in terms of what to do with the Jury this afternoon, that is all.

Mr. Boyd: Yes; I will say——

The Court: I would think, so far as the facts are concerned, that you could almost submit the case without any evidence. What you are going to do is to try and lug in something somebody said or did. As a matter of fact, the [77] actual undisputed circumstances are already in.

Mr. Boyd: Except that insofar as the Austin Company is concerned, there were certain conversations and so forth that they had which would indicate that they never had any intention of bringing out this hold harmless contract.

The Court: That might be after the event.

Mr. Boyd: Yes, subsequent proceedings, of course, after the negotiation of the contract. I would think it would probably take an hour or so to put in the evidence, possibly two hours.

The Court: I think I will send the Jury home. They can come back again. Will counsel stipulate that I can send word to the Jury without bringing them back to the Court Room; that they may be excused under the usual admonition of the Court?

Mr. Boyd: Yes, Your Honor.

Mr. Healy: Yes, Your Honor.

The Court: I think you had better bring them in.

(Thereupon, the Jury was brought into the Court Room.)

The Court: Members of the Jury: The Court and the lawyers are still wrestling with a rather perplexing legal question here, so we are going to send you home now. I am sorry we had to keep you so long out there in the Jury Room, but these things sometimes take time. I am not certain whether we will require you to come tomorrow morning at ten o'clock or not; but, pending anything further that you may hear, please [78] return tomorrow morning at ten o'clock. If it appears that your services will not be necessary tomorrow morning at ten o'clock, I believe the Clerk has ways of getting in touch with you and he will let you know; but as things now stand, please remember the admonition of the Court and return tomorrow morning at ten o'clock. We will recess.

(Recess.)

The Court: Mr. Healy, do you want to make a further statement?

Mr. Healy: Judge, I really haven't very much more to say. I did notice in this Pacific Indemnity case, as I pointed out to you earlier, that was a case in which——

There is something I wanted to say. Mr. Siebold asked me to call it to your attention. On this first page, right above insurance, in paragraph 6 there is a provision concerning patents. Did Your Honor see that? It says:

> "Vendor agrees to hold and save purchaser harmless from and against all and every demand or demands of any nature or kind by

reason of the use of any patented invention, article or appliance, that has been or may be adopted or used in the construction of any of the material or articles called for on this purchase order."

I want to call that to your attention, that those are seven different conditions which in reality form a part of this [79] order. They were things in which the vendor agreed, as Mr. Boyd would say, to hold harmless. There are two different definite things that we might classify as hold-harmless agreements.

I take it that if under that provision the vendor were to use some patented article, say a valve of some sort, and installed it, and it was discovered that that belonged to some other firm or person and that they had stolen it, we will say, or infringed upon their patents, and these other people came after the Austin Company and they would say in effect, "What are you doing, using our patented articles there?" Under that provision the Austin Company could come back to the Viking Company and ask, request, demand and secure reimbursement for any loss it might suffer. That is a loss that would be occasioned by the dereliction of the Viking Company in the inception; but anybody who continues to use a patented article with knowledge that it is stolen goods, I think there is a liability under the law. I am not familiar with patent law, but in a general way I understand this to be the rule: If a person continues to use an article that

is known to be a stolen or copied article, there can be a liability.

So we see then where this Sprinkler Company is obligating itself not only for its own dereliction in stealing the patent in the beginning but for the continuing dereliction of [80] the use of the thing.

Again, we have an instance right on that same page——

The Court: Again, there, it must be admitted that it is only articles that the Sprinkler Company itself would cause to be put into the job, so that it is acts on its own part that are referred to. It certainly couldn't be argued, could it, under the provisions of paragraph 6 that have to do with patents, but that obligation would refer to some material that the Austin Company, for example, would insist that they furnish and that the Sprinkler Company would be compelled to use.

Mr. Healy: No.

The Court: You couldn't argue that there would be a liability under that provision for that sort of thing, could you? Because it says: "That has been or may be adopted or used in the construction of any of the material or articles called for on this purchase order."

Mr. Healy: I see. Let us say they put in fittings or valves of the Crane Company. Maybe I didn't understand Your Honor's question. Suppose it put in some valves that were later developed to belong to X.Y.Z. Corporation, they had the exclusive license, and this Viking Company put them in knowing that it was performing a tortuous act, the

Viking Company could be held liable under the patent law.

The Court: The Viking Company could be held liable by the [81] patentee, yes.

Mr. Healy: That is what it is talking about, suits by a patentee. Then suppose that knowledge came over to the Austin Company, and there were just dozens of these valves all over the place, and they said, "All right; there they are, we know about them; we aren't going to do anything about them," I think the patentee has a remedy against the user of the article, too, from what little I know again about patent law. So again there would be two independent tortuous acts; one, the putting in to begin with; and, second, the continued use by the Austin people; and the Austin people would be able under this paragraph 6 as I read it, to require the Viking Company to hold it harmless for the dereliction of the Austin Company itself, the independent dereliction, the continued user dereliction.

The Court: That would be a strained sort of philosophy to inject into these kind of contracts; for example, we will say the Austin Company would specify that you had to use Crane pipe No. 422, of such and such specifications——

Mr. Healy: Yes.

The Court: Say pursuant to that specification, the Viking Company would use that, and they would find that after they used it that the patentee came along and sued them and also sued the Austin Company for continuing user. Now, would it be a

fair interpretation of that provision of the contract [82] under these circumstances that the Viking Company would have to defend the suit against the Austin Company to hold the Austin Company harmless from liability?

Mr. Healy: Isn't that what it says: "All and every demand or demands." Again we get our old word "all"; it can't be any more than all demands.

The Court: If that is the sole basis of the contention here, I think, as we told the Jury, that we do not check our common sense at the entrance to the Courtroom and that that would be so unfair an interpretation of the contract that good conscience would rebel against adopting it. It isn't the sort of thing—we don't just foist secret and unfair obligations of that kind; we don't interpret contracts except in a way that would justly effectuate the agreed purposes of the contract. Unless the parties have elected with their eyes open to perform some contract that would appear on its face to be very burdensome, the Court is not going to put that burden on them. Of course, we do not make a new contract for the parties, that is true; but in interpreting the contract we do not do something in the way of interpretation that would really be unjust.

The Insurance Company would pay this claim here. Personally, my view of the matter is that it would be extremely unjust, Mr. Healy, to foist this kind of liability under the terms of this contract on the Viking Company. Under the [83] background of the circumstances here involved, it would be ridiculous to assume that the Viking Company

was undertaking to hold the other company harmless from what might be the most grievous of misfeasances that it might commit, the most negligent acts of omission by which employees might be hurt, or third persons lawfully invited on these premises might suffer. It doesn't seem to me to be reasonable.

I appreciate that the Courts seem to have concerned themselves with some cases of this kind in the past, but at least in the two California cases that were cited,—although in one case the liability was recognized, was approved by the Court, and the other one it wasn't; but in both cases the provisions involved were certainly more specific and in neither of those cases was the Court called upon to interpret such a broad word as "all claims." Even in the case of general releases where "all claims" are mentioned, they still have to have a reasonable, pertinent and material relationship to the objects and purposes of the contract as disclosed by the contract against the background of the circumstances in which they are entered into.

I don't think that would be right, Mr. Healy; it doesn't seem to me that that interpretation would be proper under the circumstances as they appear here so far.

Mr. Healy: I have just two more thoughts and I will rest, Judge, if I may be allowed to. [84]

The Court: If this weren't a Jury case, I would be very glad to extend further time to you,——

Mr. Healy: Yes, I understand.

The Court: ——to present anything that you

wish in connection with the matter. We do have a Jury case before us, and I think that cases of this nature should be promptly disposed of.

Mr. Healy: Absolutely.

The Court: I don't want to take any snap judgment in the case, but a Judge does have to rule on these matters when they come up in the course of the trial and procrastination is worse than no decision at all sometimes. It is better to determine these questions and if there is dissatisfaction there is always the right of appeal.

Go ahead with what you have to say.

Mr. Healy: These are the thoughts. When I was commenting upon paragraph 6 it was merely to point out that in these seven conditions there are two distinct provisions concerning themselves with holding the Austin Company harmless. Now, if you construe those two together and keep in mind Article XII that provides for insurance, does it not become all the more cogent that 7, which concerns itself with public liability and damages for personal injuries and the like—that that is a whole article devoted to the obligation of the subcontractor to carry the type of insurance [85] that would cover the liability I contend for under 7.

Under 6 I don't say that there is any corresponding type of insurance to cover Viking Company for any dereliction it might have in the field of patents. In other words, if Your Honor construes 6 as only to cover tortuous acts in the field of patents as of the torts of the Viking Company itself and not any torts over here by the Austin Company, doesn't the

whole thing become more apparent then? The Austin Company doesn't agree to that, and therefore they do not require them to carry insurance. But when you get over into the personal injury field it requires them to carry insurance. That is Number One. However, I won't labor it any further. If I said it fifty times, I couldn't say it any more clearly. That is that point. Again we are construing things.

I want to call Your Honor's attention to this language in the Pacific Indemnity case—how much stronger it is; it says:

> "You will indemnify and save Company harmless from and against any and all loss, damage, injury, liability, and claims therefor, including claims for injury or death to Company's employees and damage to Company's property and claims of liens of workmen and materialmen, howsoever caused, resulting directly or indirectly from the performance of this agreement." [86]

Now, I daresay to Your Honor that if the Trial Judge had gone the other way and had decided as a factual matter that he thought this covered the negligence of the Standard Oil Company as well as the negligence of the Electric Company, that the Court on review would have affirmed it. I daresay so. I do not think that is any stronger. There are more words, but again it doesn't do the thing that Mr. Boyd claims must be done exclusively in haec verba cover the negligence indemnity. It doesn't do that; it just says, "against any and all loss, damage, injury, liability, and claims therefor, howsoever caused."

Now, if you can put in "howsoever caused" you can put in the time, place and everything else. If it is "all claims" it can't be more all-embracing. That is my second thought.

The Court: On that subject you have a further clause here that would throw grave doubt as to whether or not this clause 7 means "all claims howsoever caused," because the provision here is:

> "Agrees to protect and indemnify the buyer against all claims for damages, lawsuits, etc., which may arise due to difficulties encountered while vendor is servicing this operation."

Now, would you say that a difficulty encountered by the vendor while servicing this operation would be a misfeasance of the vendee?

Mr. Healy: The vendor is the Viking Company. You mean [87] the other way, don't you?

The Court: Would you say that a difficulty encountered while the Viking Company is servicing this operation refers to and would include a misfeasance and negligence of the Austin Company?

Mr. Healy: I am really sorry; I don't get Your Honor's question. I hesitate to answer it; I just don't understand it.

The Court: All right; I will put it to you this way: In the other cases there is a clause in the contract that provides that there shall be an indemnification and saving harmless against all claims and demands howsoever they may be caused. This contract does not say that. This says,

> "All claims for damages, lawsuits, etc., which may arise due to difficulties encountered while Viking is servicing this operation."

Mr. Healy: Yes.

The Court: Would you say that "difficulties encountered while Viking is servicing this operation" would by any stretch of the imagination refer to damages resulting from the sole negligence of the Austin Company? Would that be a difficulty which Viking would encounter in its operations under the contract?

Mr. Healy: No, I think it means that it must touch or concern some Viking operation, although the Viking Company [88] need not be the tortuous one.

The Court: But isn't that a description of the meaning of "all claims" that is referred to there?

Mr. Healy: I would never contend if a workman of X Company some distance removed in time and in place—let us say in place, but say the time was the same—some distance removed from the Viking operation—was injured through the dereliction of Austin men—I don't think that this was ever intended to hold Viking for it. I think that it all had to arise out of the Viking operation. And it is stipulated here that these two men were employees of and within the course of their employment on the job. That is all I think that means, Judge.

The last point is this: Let me put it this way: In this P. I. case they quoted from Murray vs. Texas Company, a South Carolina case. I will just read this sentence.

> "We think the Trial Judge properly refused to grant the motion for a directed verdict on this ground."

I do not have who was moving for a directed verdict, but it must have been the defendants; they are generally the ones, though I am not sure.

> "As stated by him, the provision of a contract relieving one of the parties thereto from liability for his or its own negligence should be [89] clear and explicit. While it is true that the language used in the quoted provision of the contract before us, that the agent shall hold the company 'harmless from all claims, suits and liabilities of every character whatsoever and howsoever arising from the existence or use of the equipment at said station,' is broad and comprehensive, it is, as stated by the Court below, provocative of some doubt."

Now, I contend that at the most this thing is provocative of doubt, and I am standing, and my clients have asked me to stand on our legal rights. This is a motion to dismiss. And I say that if the Court has taken the view—though I thought it was the rule otherwise—that we are to explain the doubts, then I should be at least allowed to bring back Mr. Johnson again on that very question. We could take that evidence without waiting for tomorrow and the Jury; we could take it out of the presence of the Jury and if it goes one way, it could be read to the Jury. Is it not the rule on a motion to dismiss if the plaintiff has failed in any particular item of proof he should be allowed to supply that missing link, so to speak?

Certainly if what I have been informed—and I don't know, but that is what I want to explore—that this Company, this Viking Company are insured by an insurance company—[90] I have been told it is the Firemen's Fund—and they have a contractual rider on their policy, or rather a rider to cover contractual liability and they paid an extra premium for that, I submit that it has probative value.

The Court: Against what liability do you say they are insured?

Mr. Healy: I would say then it would be against their liability——

The Court: You say that they are insured against negligence of the contractor in this case, of the Austin Company?

Mr. Healy: Judge, I don't want to say anything that I couldn't prove. I have never seen it, and it is pure hearsay to me.

The Court: I can't convert the case into a discovery proceeding. Maybe the other side would stipulate, subject to its materiality.

Mr. Healy: We are entitled to question these adverse witnesses, aren't we?

The Court: Yes, that is true, but, of course, I think that proper caution should dictate to you not to ask something like that unless you are fairly certain that you are going to get a favorable answer. If you asked that question and it developed that it wasn't true, you would be much worse off than you are now. I think that is something that you should have discovered before the trial, not in

the trial. However, [91] I am not meaning to be critical; I am just merely suggesting that that might be harmful to you to present. That is a matter which should have been gone into before the trial commenced.

Mr. Healy: I believe under the rules here, that are the same as the State Rules, I can question an adverse witness without being bound by his adverse answers.

The Court: Yes, but if you weren't bound by their answers, there would still be in the record something that would be very strong against you as to the intention on the part of the other side. I don't think that would particularly avail you.

Mr. Healy: We ask permission to question the man along those lines.

The Court: Of course, we have got a Jury here now.

Mr. Healy: I say why couldn't we do that right now here? I don't know. If it developes that——

The Court: Of course, the Jury wouldn't hear the witness testify. If it would determine that there was some factual matter, why, that might possibly go to the Jury. I don't know that there is anything so far—there certainly isn't anything in your case as it is now submitted that requires anything to go to the Jury. Your opponent could rest the case now.

Mr. Healy: That is a correct statement. I believe, if my contentions are correct, if there were no more evidence, [92] Your Honor would have to

instruct the Jury to return a verdict for the plaintiff, I would think, because, as you say, there is no factual issue, there is no dispute.

The Court: I don't know. Your opponent says that he wanted to present some evidence as to conversations held afterward, which I think in all probability might be excluded because of the fact that it has no reasonable relationship to the time in which the contract was entered into and did not form a part of the making of the contract, unless it would be admitted as evidence of some sort of an adverse admission. That would be the only theory upon which it could be proper.

Mr. Healy: May I intrude on Your Honor's thoughts? Back again to this question of discovery procedure——

The Court: I am perfectly willing if counsel is willing, in the absence of the Jury; but I don't see how we could do that in connection with this matter that is pending before us without reopening the matter and interrogating the witness if you wish to pursue that inquiry; but I think we would have to do it in the presence of the Jury.

Mr. Healy: The testimony could be read to the Jury.

The Court: Well, if you wanted to enter into some sort of a stipulation, that is agreeable.

Mr. Boyd: Your Honor, I haven't said anything for some time; I have been waiting.

The Court: You were very wise. It is always the safer [93] and smarter thing not to say much when the Judge is talking for you.

Mr. Boyd: I appreciate that, Your Honor, but I really don't know what Mr. Healy hopes to prove by these questionings. I would like to ask what he expects to prove by further questioning. Maybe I will stipulate.

The Court: What is it?

Mr. Boyd: In other words, I will stipulate the Viking Company carried insurance for many, many years, there is no question about that, to protect themselves for liability imposed upon them by law, just the same as Austin Company carries insurance with the General Accident Insurance Corporation to protect them for liability imposed upon them by law. There is no doubt in the world about that. But my objection was made on the materiality of the questioning, particularly when the vendor-vendee agreement merely states in effect that the vendor represents that it will carry insurance. That has nothing to do with the hold-harmless part of the agreement. And certainly Viking Company has no coverage that agrees to assume liability for the sole negligence of the Austin Company. It would just be ridiculous to even ask them to pay for such insurance, particularly when the Austin Company already carries insurance.

The Court: Have I made myself clear?

Mr. Healy: You have made yourself clear, but I think [94] counsel has evaded the issue; that is, that we are talking informally, the Firemen's Fund Indemnity Company wrote a letter, and that is the source of my information, back to the Austin Company. These letters that we put in evidence by the

Austin Company to the Viking were apparently referred to the Firemen's Fund. I haven't the letter, but the gist of it was, "We respectfully decline liability for your claim." They never contended that they did not insure on it; they just denied liability.

Furthermore, I am told by Mr. Siebold that the manager of Firemen's Fund told them that there was a contractual rider on their policy. Counsel particularly said they never insured against the sole negligence of Austin. That is an argument, but ordinarily you do not have contractual riders on policies unless there is a reason for it, and I think it has probative force.

The Court: Then that is something that you should have inquired into before the case was filed, and then maybe you could have joined Firemen's Fund as a defendant and let the two insurance companies fight it out. In my opinion, that would have been a more just and appropriate way to determine it.

Mr. Healy: That is what they are doing in effect, anyway; we all know that—I mean, in effect. I don't think there is any doubt but what the Viking Company is being protected [95] by the Firemen's Fund in this very suit.

Mr. Boyd: Well, certainly, counsel, I think that you will agree that the Firemen's Fund stands in the same position as the Viking Company, the same as your concern does as to Austin.

Mr. Healy: That is right.

Mr. Boyd: So we are right back to where we

started: What is the agreement between the two companies?

The Court: I think you are correct about that, yes.

Is this motion submitted?

Mr. Healy: I ask permission to question that man upon his policy. I think you can take that outside of the presence of the Jury.

The Court: To save your record in the matter, I will hold that that is immaterial, and I will sustain the objection to that testimony as to the purpose for which it is sought.

Mr. Healy: It will be understood that I have asked the question clearly, we all understand the force of it, and it was argued.

The Court: It will be understood that you have asked the same question again that you asked previously, and that I sustained the objection on the ground that that is immaterial to the resolution of this question.

Mr. Healy: Very well. [96]

The Court: So that your rights are protected,—at the conclusion of plaintiff's presentation of its case, the defendant has made a motion to dismiss this case.

It appears to the Court, upon the evidence presented in behalf of plaintiff, that there has been a failure to present facts sufficient to sustain the allegations of the complaint in this case.

In the opinion of the Court, paragraph 7 of the contract between the defendant and the Austin

Company does not give rise to a cause of action on behalf of the plaintiff to recover for the damages paid and expenses incurred due to the negligence of the Austin Company.

In my opinion, the provision of the contract itself is not susceptible to that interpretation. The case is different from the cases cited which were decided by the California Courts where provisions of contracts somewhat comparable were involved, because in those cases the contracts specifically provided that the alleged indemnitor should assume liability for all claims and damages however caused during the performance of their contract.

The particular provision of the contract in this case is limited, and, in my opinion, does not fall within the purview of the rule asserted in the California cases that have been referred to.

I think there is nothing presented by way of evidence in [97] this case that would justify the submission of the case, and there is nothing, so far as I can see, that could be presented by the defendant that would aid the Court in determining the matter. All of the circumstances that are necessary for an evaluation of the liability of the defendant are before the Court, having been presented by the plaintiff in this case, and anything beyond that would consist of hearsay or ex post facto discussions which would not be legally pertinent so far as the issue of the interpretation of this provision of the contract is concerned.

Accordingly, the Court will grant the motion for a dismissal upon a finding of the Court that the

evidence affirmatively shows that the liability asserted does not, under the contract between the parties, rest upon the defendant in this case.

I think, under the provisions of the rule, that findings should be presented on the motion to dismiss even though it is a jury case. It would serve to indicate in a factual way the basis upon which the ruling of the Court is made.

Certificate of Reporter

I, W. A. Foster, Official Reporter and Official Reporter, pro tem, certify that the foregoing transcript of 98 pages is a true and correct transcript of the matter therein contained as reported by me and thereafter reduced to typewriting to the best of my ability.

/s/ W. A. FOSTER.

[Endorsed]: Filed March 26, 1951. [98]

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO RECORD ON APPEAL

I, C. W. Calbreath, Clerk of the United States District Court for the Northern District of California, do hereby certify that the foregoing and accompanying documents and exhibits, listed below, are the originals filed in this Court in the above-entitled case and that they constitute the record on appeal herein as provided in the stipulation of attorneys for record on appeal:

Complaint for damages.

Notice of motion to dismiss.

Order denying motion to dismiss (Judge Erskine, July 24, 1950).

Answer.

Findings of fact and conclusions of law.

Decree.

Notice of appeal.

Stipulation for record on appeal.

One volume of testimony.

Plaintiff's exhibit 1.

Plaintiff's exhibit 2.

Plaintiff's exhibit 3.

Plaintiff's exhibit 4.

Plaintiff's exhibit 5.

In Witness Whereof I have hereunto set my hand and affixed the seal of said District Court this 30th day of March, 1951.

[Seal] C. W. CALBREATH,
Clerk.

By /s/ D. M. TAYLOR,
Deputy Clerk.

[Endorsed]: No. 12889. United States Court of Appeals for the Ninth Circuit. General Accident Fire and Life Assurance Corporation, Ltd., a corporation, Appellant, vs. Viking Automatic Sprinkler Company, a corporation, Appellee. Transcript of Record. Appeal from the United States District Court for the Northern District of California, Southern Division.

Filed March 30, 1951.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

[Title of Court of Appeals and Cause.]

STIPULATION FOR CONSIDERATION OF ORIGINAL EXHIBITS BY COURT WITHOUT NECESSITY OF REPRODUCTION IN THE RECORD

It is Hereby Stipulated by and between appellant and appellee, through their respective counsel, that all the original exhibits introduced in evidence in the District Court, except Plaintiff's Exhibit No. 1, may be considered by this Court and referred to by counsel in their original form without the necessity of reproduction in the record.

Dated: April 3, 1951.

HEALY & WALCOM,

/s/ JOHN J. HEALY,
Attorneys for Appellant.

BOYD, TAYLOR & REYNOLDS,

/s/ ROBERT F. REYNOLDS,
Attorneys for Appellee.

So Ordered:

/s/ WILLIAM HEALY,
Chief Judge.

/s/ WM. E. ORR,
United States Circuit Judge.

No. 12,889

IN THE

United States Court of Appeals

For the Ninth Circuit

GENERAL ACCIDENT FIRE AND LIFE ASSURANCE CORPORATION, LTD. (a corporation),

Appellant,

vs.

VIKING AUTOMATIC SPRINKLER COMPANY (a corporation),

Appellee.

Appeal from the United States District Court, Northern District of California, Southern Division.

APPELLANT'S OPENING BRIEF.

HEALY AND WALCOM,
68 Post Street, San Francisco 4, California,
Attorneys for Appellant.

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No. 12,889

IN THE

United States Court of Appeals

For the Night Circuit

GENERAL ACCIDENT FIRE AND LIFE ASSURANCE CORPORATION, LTD. (a corporation),

Appellant,

vs.

VIKING AUTOMATIC SPRINKLER COMPANY (a corporation),

Appellee.

Appeal from the United States District Court, Northern District of California, Southern Division.

APPELLANT'S OPENING BRIEF.

STATEMENT OF THE PLEADINGS AND FACTS DISCLOSING BASIS OF COURTS' JURISDICTION.

This is an appeal from a judgment or decree, as it was called, entered in the United States District Court, Northern District of California, Southern Division, on the 30th day of January, 1951, dismissing appellant's complaint.

The District Court had jurisdiction of the cause under the provisions of Title 28 U.S.C.A., Section 1332-2.

The United States Court of Appeals for the Ninth Circuit has jurisdiction upon appeal to review the judgment of the District Court below under the provisions of Title 28 U.S.C.A., Section 1291.

STATEMENT OF THE CASE.

The printed record on appeal consists of the pleadings and formal documents (page 3-page 24); the opening statements of counsel (page 26-page 55); certain stipulations, receiving of documents in evidence, and questions propounded to the witness Johnson (page 55-page 80); defendant's motion to dismiss together with arguments of counsel and discussions with the Court (page 80-page 131). The case was tried by the Court sitting with a jury. At the conclusion of the appellant's case the appellee moved to dismiss (R. 80), which motion was granted (R. 129).

The appellant, a corporation organized under the laws of Great Britain, was authorized to conduct an insurance business in California and had issued a comprehensive liability insurance policy to the Austin Company. The Austin Company being engaged in the construction business had a contract to erect certain buildings for the City and County of San Francisco at the Mills Field Air Port. The Austin Company engaged the appellee, Viking Company, as a subcontractor to install a sprinkling system in these buildings. The contract was in writing and is set forth beginning at R. 56.

Two workmen, named Estrada and Taylor, who were employees of the Viking Company, while working on the job at Mills Field and within the course of their employment were injured solely as a result of the negligence of the Austin Company. (R. 28, 73.) Estrada obtained a judgment against the Austin Company in a State Court in California for $12,500. Taylor's claim was settled. The appellant pursuant to its policy of public liability insurance and on behalf of its assured the Austin Company paid Estrada the amount of the judgment, made the settlement with Taylor, and paid other sums for attorneys' fees and expenses. The total amount of all of these payments amounted to $19,458.24. These facts were stipulated and agreed to. (R. 72.) That they were reasonable was not questioned. (R. 73.)

Appellant being subrogated to the rights of its assured, the Austin Company, sought by this action to recover against the Viking Company for the sums it had expended under the indemnity agreement which was incorporated in the contract between Austin Company and Viking Company. That agreement was set forth in part in the complaint (R. 5), and appears in the main contract, Appellant's Exhibit No. 1 (R. 58). It is also set forth in this brief, infra, p. 5.

The evidence in this case was practically all received by stipulation. (R. 55-77.) After the main contract and certain other exhibits were received in evidence and the stipulation of facts made, appellant, realizing that the indemnity provision of the contract was am-

biguous, attempted to clear up the latent ambiguity in order to show the true intent of the parties by calling the witness Samuel A. Johnson to develop certain facts. Upon objections made by appellee, appellant was prevented from presenting evidence to explain the latent ambiguity and upon motion made by the appellant (apparently under Rule 41, F. R. C. P.) the Court took the case away from the jury and dismissed the action.

QUESTIONS INVOLVED.

1. Where an action is brought on a contract containing a latent ambiguity, should not the plaintiff be allowed to introduce all the material evidence that would explain the ambiguity?

2. Is it not reversible error for the trial Court to refuse to allow plaintiff to introduce such evidence and order a dismissal of the action?

SPECIFICATION OF ERRORS.

The appellant specifies as error and intends to urge the following errors were committed by the Court below in dismissing appellant's complaint and entering judgment for appellee.

1. In refusing to allow appellant to question and prove by the witness, Samuel A. Johnson, that the appellee had a contract of public liability insurance

with a contractual endorsement on it that covered the liability sought to be established by appellant. (Record set forth at p. 9, infra.)

2. In taking the case from the jury and dismissing the action.

ARGUMENT.

I.

THE CONTRACT CONTAINED ENFORCEABLE INDEMNITY PROVISIONS INDEMNIFYING AGAINST THE NEGLIGENCE OF THE AUSTIN COMPANY.

The contract of indemnity upon which appellant maintains this action is contained in paragraph 7 and Article XII of the contract between Austin Company and appellee Viking Company. Those provisions read as follows (R. 58):

> "7. Insurance—It is understood and agreed that vendor is fully covered with Public Liability, Workmen's Compensation and Property Damage insurance and agrees to protect and indemnify the Buyer against all claims for damages, lawsuits, etc., which may arise due to difficulties encountered while vendor is servicing this operation."
>
> "ARTICLE XII. Insurance
>
> Subcontractor shall, during the progress of the work maintain: (a) Workmen's Compensation Insurance for all of its employees employed at the site of the work, or if such insurance is not required by the laws of the state wherein the

work is to be performed, Employer's Liability Insurance; (b) Contractor's Public Liability Insurance; and (c) Automobile Liability Insurance.

The limits of liability provided in Subcontractor's Public Liability Insurance Policy shall be $100,000.00 for injuries, including accidental death, to any one person, and subject to the same limit for each person, $200,000.00 for any one accident involving two or more persons. Such policy shall also provide for property damage liability of $10,000.00 for any one accident and subject to the same limit total aggregate liability of $50,000.00. The limits provided in Subcontractor's Automobile Liability Insurance Policy shall be $100,000.00 for injuries including accidental death, to any one person, or subject to the same limit for each person, $200,000.00 for any one accident involving two or more persons. Such policy shall also provide a property damage limit of $10,000.00, covering all owned and rented equipment which is used in or on the work.

Should any part of this Contract be sublet, Subcontractor shall, in addition to the foregoing types of insurance, maintain Contractor's Protective Liability Insurance in the amount of $100,000.00 for injuries, including accidental death, to any one person, and subject to the same limit for each person, $200,000.00 for any one accident involving two or more persons, except that Contractor's Protective Liability Insurance need not be maintained to the extent that its Subcontractor maintains Workmen's Compensation, Employer's Liability Insurance and Contractor's Public Liability Insurance, and Automobile

> Liability Insurance, as above set forth, and provided Contractor is named as an additional insured in such policies of insurance. Certificates of all such insurance shall be furnished to Contractor."

Under the substantive law of the State of California, which the Federal Courts will apply, *Erie R. Co. v. Tompkins,* 304 U.S. 64, 58 S. Ct. 817, 82 L. Ed. 1188, a contract to indemnify the indemnitee against his own negligence is not against public policy, and is enforceable in a court of law. Attention is respectfully directed to the cases of *Southern Pac. C. v. Fellows,* 22 C.A. (2d) 87, 71 Pac. (2d) 75, and *Pacific I. Co. v. California etc. Ltd.,* 29 C.A. (2d) 260, 84 Pac. (2d) 313. The opinions in those two decisions are too lengthy to quote *in extenso* and excerpts therefrom would hardly suffice, therefore we respectfully urge the Court to peruse the opinions themselves.

II.

THE CONTRACT WAS AMBIGUOUS AND REQUIRED THE RECEIVING OF EVIDENCE IN ORDER TO CLARIFY IT AND DETERMINE THE INTENT OF THE PARTIES.

Prior to the time this action was at issue appellee moved to dismiss the complaint under F.R.C.P. 12d. (R. 9.) The matter was heard before the late Honorable Herbert W. Erskine who filed a memorandum order. (R. 10.) For convenience we will set forth Judge Erskine's order:

"Order

As in the case of Pacific Indemnity Co. v. California Electric Works, Ltd., 29 Cal. App. (2d) 260, there appears to be a latent ambiguity in the contract provisions in issue here, requiring the taking of testimony to explain what the parties meant by said provisions and to determine whether the contract was intended to indemnify the plaintiff against its own negligence. Defendant's motion to dismiss is therefore denied.

Dated: July 24th, 1950.

/s/ Herbert W. Erskine,
U. S. District Judge."

After the appellant had proved the relationship of the parties, the existence of the contract, the injury to the workmen and amount paid to them pursuant to its policy of insurance, it called the witness Samuel A. Johnson to explain the latent ambiguity in this indemnity agreement that was recognized and referred to by Judge Erskine in his order above set forth. Appellant attempted to show a policy of public liability insurance carried by appellee with a contractual endorsement thereon that covered the precise liability contended for and contemplated by paragraph 7 and Article XII above set forth.

This the Court refused appellant the right to do and made a ruling that the same was immaterial. In accordance with Rule 20(D) of this Court we will set forth the portions of the record showing the offer, the objection and the ruling of the trial Court concerning the proffered evidence.

"By Mr. Healy. Q. Are you connected with the defendant Viking Company?

A. Yes, sir.

Q. In what capacity?

A. I am an employee, an engineer.

Q. Are you an officer?

A. No, sir.

Q. Are you a manager?

A. Only insofar as I handle things when the manager isn't here.

Q. I will just ask you this: Are you famliiar with this (40) contract that is here in evidence between the Viking Company and the Austin Company?

A. Yes.

Q. And you are familiar with this paragraph 7 that we have discussed?

A. Yes.

Q. I was going to ask you whether or not pursuant to the terms of that contract, your company did in fact take out public liability insurance.

Mr. Boyd. If Your Honor please, that is entirely immaterial. Objected to on that basis; no issue as to whether there is any insurance of any kind as far as its intent was concerned.

Mr. Healy. May I be heard?

The Court. I don't quite see the materiality whether they took it out or not. Their insurance company is not being sued; they are being sued.

Mr. Healy. That is right. But may I read the provision to Your Honor? It says:

> 'It is understood and agreed that vendor is fully covered with public liability, workmen's compensation and property damage insurance.'

It is right on the first page, right down by 7; right down in this corner of the green one. It is more legible.

The Court. All right; I have it. (41)

Mr. Healy. I intend to show—I think I can show that—that that intent seems to be an essential ingredient, says Mr. Boyd—that they did in fact take out this type of insurance, and not alone that, but they had a contractual endorsement on it, so that they were well insured. If I can prove that, it would have probative value.

Mr. Boyd. If Your Honor please——

Mr. Healy. ——that they did cover this type of situation. So I think it is very material and has considerable probative value.

Mr. Boyd. If Your Honor please, there are no allegations pertaining to insurance, compensation or any other kind in this action; it is entirely immaterial. The only question that is alleged in the complaint and the only one that has been mentioned, is whether or not the agreement that has been entered into was in effect a hold-harmless agreement protecting not the insurance company, but the insured, the Austin Company, for the——

The Court. I am inclined to think that that might not be admissible, because of the fact that one might take out a public liability insurance policy to protect one against something that one might not be liable for. That sometimes happens.

Mr. Healy. Yes, but if they had a contractual endorsement on it, wouldn't it have a probative value that they realized (42) that they were exposing themselves by this contract to a contrac-

tual liability as distinguished from a tortuous liability and paid an extra premium for it?

The Court. It might be competent if the defendant were to offer some evidence by way of rebuttal, or offer evidence on their part to that effect.

Mr. Healy. Very well.

The Court. But I don't think at this stage of the case it would be admissible?

Mr. Healy. Very well, Your Honor. With that in mind I will withdraw my question. You may step down." (R. 77-80.)

*　　*　　*　　*　　*　　*　　*

"The Court. Of course, if that were necessary to be raised as a part of the affirmative burden of proof, then the Court should permit at this time the question that Mr. Healy asked of Mr. Johnson to be answered, if it is a part of the affirmative burden.

Mr. Boyd. I don't think that insofar as whether or not Mr. Johnson carries insurance would in any way affect in any way the meaning or interpretation——

The Court. If the plaintiff has the burden of showing the true intent of the parties, and as you have just said, he has not carried that burden, then he would have the right if (51) he could show it, if there is any evidenciary matter that might be corroborative of the intent of the defendant.

Mr. Boyd. I agree one hundred per cent that if he has any evidence that would tend to interpret or set forth the intent of the Austin Company to cover this particular situation—any evidence that he has—he not only has the right, as

I see it, Your Honor, but also the duty to come forward with his evidence and show what the intent was.

The Court. But you objected to the question that he asked along that line.

Mr. Boyd. That was on the question of insurance.

The Court. Yes, but it was his contention that the fact that the defendant may have taken out insurance to cover the kind of liability that is referred to in paragraph 7 of the agreement might be evidenciary in character as to the intent with which the language in paragraph 7 was used." (R. 87-88.)

* * * * * * *

"Mr. Healy. We ask permission to question the man along those lines." (R. 125.)

* * * * * * *

"Mr. Healy. I ask permission to question that man upon his policy. I think you can take that outside of the presence of the Jury.

The Court. To save your record in the matter, I will hold that that is immaterial, and I will sustain the objection to that testimony as to the purpose for which it is sought.

Mr. Healy. It will be understood that I have asked the question clearly, we all understand the force of it, and it was argued.

The Court. It will be understood that you have asked the same question again that you asked previously, and that I sustained the objection on the ground that that is immaterial to the resolution of this question.

Mr. Healy. Very well." (R. 129.)

In suing on a contract that is ambiguous a party has a right and a duty to present all the facts and circumstances surrounding the transactions to enable the Court to properly interpret the instrument. The rule is well expressed in 17 *C.J.S.* 1242 where it is said:

> "If a written contract is ambiguous or obscure in its terms, so that the contractual intention of the parties cannot be understood from a mere inspection of the instrument, extrinsic evidence of the subject matter of the contract of the relations of the parties to each other, and of the facts and circumstances surrounding them when they entered into the contract may be received to enable the Court to make a proper interpretation of the instrument."

III.

THAT APPELLEE HAD INSURED AGAINST THE VERY LIABILITY SOUGHT TO BE ESTABLISHED WAS IMMATERIAL.

It has been recognized many times by the Appellate Courts in California that the carrying of insurance has great evidentiary value in determining what the true intent of the parties may be. This rule has been applied in a number of different situations. The rule and the reason behind it is well expressed in the case of *Perry v. Paladini, Inc.*, 89 Cal. App. 275, 264 Pac. 580, where the Court said:

> "Defendant had denied that it was the owner of the truck and had denied knowing anything

about an insurance policy, and this testimony had been given by the president, Alex Paladini. It was competent to show every act of ownership on the part of defendant or its officers, and if results flowed therefrom not anticipated this is appellant's misfortune brought about by its own misconduct. It has been a well-established principle of law for many centuries that upon a trial for a particular crime evidence which shows or tends to show the commission of another and distinct crime by a defendant is inadmissible, and it is prejudicial error to let it go before the jury. This rule has its exceptions, and where it appears that evidence of the commission of such other crime has a direct and logical bearing upon the guilt of the accused as to the crime with which he is on trial evidence of the commission of such other offense is admissible (*People v. Argentos,* 156 Cal. 725 (106 Pac. 65)). By analogy the rule as to the instant case should be that while it is improper and highly prejudicial to allow evidence to be introduced showing a defendant is insured against liability in case of accident, yet evidence of general insurance of certain property by a defendant who denies ownership does have a direct and logical bearing upon that particular question and is therefore admissible. The plaintiff could have gone much further than he did. He would have been permitted upon his insistence to offer in evidence the application for insurance if the same had been executed by defendant or any of its authorized officers. Plaintiff, mindful of the defendant's claim of error, went no further than to show the fact of insurance. *Ordinarily, men do not insure*

the property of others; and, likewise, insurance companies do not usually issue policies covering property to one having no interest therein. And going still further, insurance companies do not roam around the byways issuing policies at their own instance and without the application of anyone.'' (Italics ours.)

See, also:

Burlingham v. Gray, 22 C. (2d) 87, 137 Pac. (2d) 9;

Mullanix v. Basich, 67 C.A. (2d) 675, 155 P. (2d) 130;

Curcic v. Nelson Display, 19 C.A. (2d) 46, 64 P. (2d) 1153.

The Court should have received evidence of the existence of the contractual rider or endorsement to cover the liability contended for.

IV.

ON A MOTION TO DISMISS THE COURT MUST VIEW THE EVIDENCE MOST FAVORABLY TO THE PLAINTIFF (APPELLANT).

A reading of the main contract between Viking Company and appellant (R. 56) will demonstrate that Viking Company was not the agent of appellant in any sense of the word, but was an independent contractor. In certain instances it was provided that the contractor should be named as an additional insured in such policies of insurance. In all instances

certificates of such insurance were to be furnished to the contractor. (Article XII of contract, R. 62.)

Save with few exceptions such as where there is a nondelegable duty to the public or where work is inherently dangerous it is elementary that a contractor cannot be held responsible for the tortuous activities of a subcontractor. Why would the parties specifically provide for public liability insurance to cover the liability of the subcontractor? The contractor (Austin Company) could not be liable for the ordinary torts of the Viking Company. The purpose in setting forth such an elaborate scheme for insurance as is contained in Article XII together with the contractual rider that was placed thereon (which the appellant offered to prove and the Court held to be immaterial) demonstrates that the parties intended that appellee had bound itself to indemnify the Austin Company against the latter's own negligence. This was a cost-plus, a fee contract. (R. 59.) To provide insurance in the high limits required by Article XII was costly to say the least. That cost was ultimately borne by the Austin Company. It is inconsistent with good business practice and altogether illogical to have required the carrying of such insurance if the same were meaningless. As above indicated vicarious liability for tortuous conduct by Viking Company could not be imposed on Austin Company. Therefore without the existence of the contractual rider that appellant offered to prove the conduct of the parties becomes meaningless. However, if allowed to prove the

existence of the contractual rider or endorsement the intent of the parties as expressed in paragraph 7 and Article XII, at once becomes apparent. If allowed to prove the existence of the endorsement the "latent ambiguity" spoken of by Judge Erskine in his order above set forth, disappears and the appellant would have proved its case.

At one stage of the proceeding the learned trial Court apparently agreed with this view, but later decided to take the case away from the jury on the sheer grounds that the contract was unfair.

> "The Court. Of course, if that were necessary to be raised as a part of the affirmative burden of proof, then the Court should permit at this time the question that Mr. Healy asked of Mr. Johnson to be answered, if it is a part of the affirmative burden.
>
> Mr. Boyd. I don't think that insofar as whether or not Mr. Johnson carries insurance would in any way affect in any way the meaning or interpretation——
>
> The Court. If the plaintiff has the burden of showing the true intent of the parties, and as you have just said, he has not carried that burden, then he would have the right if (51) he could show it, if there is any evidenciary matter that might be corroborative of the intent of the defendant.
>
> Mr. Boyd. I agree one hundred per cent that if he has any evidence that would tend to interpret or set forth the intent of the Austin Company to cover this particular situation—any evidence that he has—he not only has the right, as

I see it, Your Honor, but also the duty to come forward with his evidence and show what the intent was.

The Court. But you objected to the question that he asked along that line.

Mr. Boyd. That was on the question of insurance.

The Court. Yes, but it was his contention that the fact that the defendant may have taken out insurance to cover the kind of liability that is referred to in paragraph 7 of the agreement might be evidenciary in character as to the intent with which the language in paragraph 7 was used." (R. 87-88.)

It is of course elementary that when considering a motion for a dismissal under Section 41, F.R.C.P., the Court must view the evidence most favorably toward the plaintiff and indulge in every legitimate inference that can be drawn from the evidence. Only when after disregarding conflicts in the evidence it comes to a conclusion that there is no substantial evidence to support a judgment can such a motion be granted. Although the cases are legion to this effect in both the Federal and State Courts, we will refer to only the following:

Gunning v. Cooley, 281 U.S. 90, 50 S. Ct. 231, 74 L. Ed. 720;

Shaw v. Missouri Pac. Ry. Co., 36 F. Supp. 651;

Slocum v. N. Y. Life Ins. Co., 228 U.S. 364, 33 S. Ct. 523, 57 L. Ed. 879;

Ohlinger's Federal Practice, Vol. 3A, p. 48.

V.

CONCLUSION.

It is respectfully submitted that the Court erred in refusing to allow appellant to question and prove by the witness Johnson that appellee had a contract of public liability insurance with a contractual endorsement; and that the Court erred in taking the case from the jury and dismissing the action. Reversible error having been committed the judgment should be reversed and a new trial granted.

Dated, San Francisco, California,
July 2, 1951.

Respectfully submitted,
HEALY AND WALCOM,
By JOHN J. HEALY,
Attorneys for Appellant.

No. 12,889

IN THE

United States Court of Appeals

For the Ninth Circuit

General Accident Fire and Life Assurance Corporation, Ltd. (a corporation),

Appellant,

vs.

Viking Automatic Sprinkler Company (a corporation),

Appellee.

Appeal from the United States District Court, Northern District of California, Southern Division.

BRIEF FOR APPELLEE.

Boyd, Taylor & Reynolds,
1303 Hobart Building, San Francisco 4, California,
Attorneys for Appellee.

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GENERAL ACCIDENT FIRE AND LIFE ASSURANCE CORPORATION, LTD. (a corporation),
Appellant,

vs.

VIKING AUTOMATIC SPRINKLER COMPANY (a corporation),
Appellee.

Appeal from the United States District Court, Northern District of California, Southern Division.

BRIEF FOR APPELLEE.

STATEMENT OF THE CASE.

The statement of the case set forth in appellant's opening brief adequately covers the facts and respondent only wishes to emphasize the stipulation to the effect that both of the accidents involved were caused by the sole negligence of the Austin Company and there was no negligence on the part of the Viking Company, its officers, agents or employees which proximately contributed in any degree to the injuries sustained by Estrada and Taylor.

ARGUMENT.

I.

APPELLANT ASSERTS THAT THE CONTRACT CONTAINED ENFORCEABLE INDEMNITY PROVISIONS INDEMNIFYING AGAINST THE NEGLIGENCE OF THE AUSTIN COMPANY.

Respondent does not quarrel with appellant's statement that the contract to indemnify an indemnitee against its own negligence is not against public policy, and is enforceable in a Court of law. Appellant cites two cases as authority for this rule, the first being *Southern Pacific Co. v. Fellows,* 22 C.A. (2d) 87, 71 P. (2d) 75, the second being *Pacific Indemnity Co. v. California, etc. Limited,* 29 C.A. (2d) 260, 84 P. (2d) 313. In those two cases, in which the language of the Hold-Harmless agreement appears to be equally broad, the Courts reached opposite conclusions, but did enunciate the rule of law as hereinabove stated.

However, the vast majority of cases throughout the United States hold that only where the contract expressly provides for an agreement by a building contractor or subcontractor to indemnify or hold harmless an owner or principal contractor for injuries resulting from his own negligence will the indemnitor be held to his contract, and only then; 175 A.L.R. 144. In this annotation, it is pointed out that there are some decisions, although few in number, where the Courts have held that clauses have been sufficiently broad to indemnify the indemnitee against its own negligence without specifically providing for the same, but they are few in number. As a rule, a contract is construed as not covering damages resulting from in-

demnitee's negligence. *North American Railroad Construction Co. v. Cincinnati Traction Co.* (1909, C.C.A. 7th), 172 Fed. 214; *Washington & B. Bridge Co. v. Pennsylvania Steel Co.* (1914; C.C.A. 4th), 215 Fed. 32; *United States v. Wallace* (1927, C.C.A. 9th), 18 Fed. (2d) 20; *Pacific Indemnity Co. v. California Electric Works* (1938), 29 C.A. (2d) 260, 84 P. (2d) 313. In the above cases, one of the reasons given for strict construction of such clauses has been that such an agreement would impose upon the indemnitor an uncertain and indefinite liability which would be entirely in the hands of the indemnitee and would not only wipe out all of the profits from the contract, but might even exceed the total consideration. In *United States v. Wallace* (1927, C.C.A. 9th) 18 Fed. (2d) 20, the Court said:

> "As is pointed out in Parry v. Payne (Pa.), supra, we should not, in the absence of language free from all doubt, conclude that the parties intended the contractor should assume an obligation which, for a single act of negligence on the part of the owner, or one of his employees, over whom the contractor had no restraint or control, would not only wipe out all profit, but would exceed the total consideration for the job."

Thus it is apparent that the language of the contract quoted at page 5 of appellant's brief, upon which reliance is based for recovery in this action, is insufficient to fix liability upon the defendant Viking Company for injuries and damages resulting solely from the negligence of the Austin Company, and so the trial Court found in its findings of fact (R. 19):

> "XIII. That the provisions of the contract itself are not susceptible to an interpretation that the defendant agreed to indemnify the Austin Co. for injuries received in accidents resulting from the sole negligence of the Austin Co., its agents, servants and/or employees."

It is the contention of the respondent that the language of the contract was not susceptible to such an interpretation and that any evidence which the appellant offered or attempted to introduce was insufficient to change the language of the contract so that it could possibly be interpreted to indemnify the Austin Co. for its own negligence.

II.

APPELLANT ASSERTS THAT THE CONTRACT WAS AMBIGUOUS AND REQUIRED THE RECEIVING OF EVIDENCE TO CLARIFY AND DETERMINE THE INTEREST OF THE PARTIES.

Respondent does not agree with appellant that the contract was ambiguous. It is the position and contention of respondent that the terms of the contract could not possibly be interpreted to indemnify the Austin Company for its own negligence and that such an interpretation could never be justified or upheld no matter what evidence was introduced by appellant.

From the inception of the case up until the appellant was about to close its case it took the position that no interpretation was needed and intended to base its entire case upon the contract, without any

evidence to indicate the intent of the parties or to aid the Court in interpretation. In the discussions between Court and counsel the following statements appear (R. 48):

> "Mr. Healy. I am willing, your Honor, to suggest this: that the matters be submitted to your Honor on the two opening statements made and further agree that the heart of the case is in the construction of that clause, and leave it to your Honor as a trier of facts and a trier of law if there is a mixed question, should there be, to decide it, and submit it to your Honor."

And again (R. 50):

> "Mr. Boyd. Well, it seems to me, that the—I don't think that the contract itself can be held to be ambiguous, so that it is a question of the intent. I don't know what the plaintiff is trying to say the various conversations were and what went on and so forth.
>
> Mr. Healy. I am not going to say anything.
>
> The Court. Apparently, as indicated by his opening statement, he is not relying on anything except the provision of the contract.
>
> Mr. Boyd. The provision of the contract, without any proof, without any evidence to explain the ambiguity or anything else?
>
> Mr. Healy. Right."

Therefore, at this late phase of the trial, appellant changed its entire theory and attempted to introduce some evidence through Samuel A. Johnson that was not admissible under any theory of law. No reason or excuse is given for the failure of appellant to be

prepared to offer admissible and documentary evidence. Appellant merely states that (Appellant's Brief 3, 4):

> "After the main contract and certain other exhibits were received in evidence and the stipulation of facts made, Appellant, realizing that the indemnitee provision of the contract was ambiguous, attempted to clear up the latent ambiguity in order to show the true intent of the parties by calling witness Samuel A. Johnson to develop certain facts."

Appellant then goes on to quote the order of Judge Erskine (Appellant's Brief 8) which reads in part as follows:

> "* * * there appears to be a latent ambiguity in the contract provisions at issue here requiring the taking of testimony to explain what the parties meant by such provisions * * *"

The order of Judge Erskine was dated July 24, 1950. Therefore, appellant, who successfully defended respondent's motion to dismiss the case before Judge Erskine on July 24, 1950, on the ground that the language of the contract presented a latent ambiguity that would require the taking of testimony, states in the present appeal that on January 15, 1951, only after the main contract and certain other exhibits were received in evidence and the stipulation of facts had been made, did it realize that there was a latent ambiguity. At that point, appellant attempted to call Samuel A. Johnson in order to clear up the latent ambiguity.

III.

APPELLANT ASSERTS THAT APPELLEE HAD INSURED AGAINST THE VERY LIABILITY SOUGHT TO BE ESTABLISHED AND THAT SUCH FACT WAS MATERIAL.

Such a fact may or may not be admissible, depending on the circumstances of each individual case. However, there is no evidence in the record nor any offer of admissible evidence or proof that the Viking Company carried a policy of insurance to which was attached an endorsement insuring them for liability incurred by contract. Article XII (R. 62) contains no provision requiring the Viking Company to carry such insurance although it sets out in detail what insurance was to be carried. Any attempt to introduce evidence that Viking Company had such insurance coverage through Samuel A. Johnson was improper and such evidence would be inadmissible for two reasons:

1. That no proper foundation was laid to show that this witness had any knowledge of the insurance carried by the Viking Co.

Mr. Johnson was called to the stand by Mr. Healy and the following occurred (R. 77):

"By Mr. Healy. Q. Are you connected with the defendant Viking Company?

A. Yes, sir.

Q. In what capacity?

A. I am an employee, an engineer.

Q. Are you an officer?

A. No, sir.

Q. Are you a manager?

A. Only insofar as I handle things when the manager isn't here.

Q. I will just ask you this: Are you familiar with this (40) contract that is here in evidence between the Viking Company and the Austin Company?

A. Yes.

Q. And you are familiar with this paragraph 7 that we have discussed?

A. Yes.

Q. I was going to ask you whether or not pursuant to the terms of that contract, your company did in fact take out public liability insurance."

2. **That the best evidence was the application for such coverage and the insurance policy or endorsement thereon if any such documents existed.**

Section 1855 of the California Code of Civil Procedure reads as follows:

> "1855. *Secondary Evidence of contents of document.* There can be no evidence of the contents of a writing, other than the writing itself, except in the following cases:
>
> 1. When the original has been lost or destroyed; in which case proof of the loss or destruction must first be made.
>
> 2. When the original is in the possession of the party against whom the evidence is offered, and he fails to produce it after reasonable notice.
>
> 3. When the original is a record or other document in the custody of a public officer.
>
> 4. When the original has been recorded, and a certified copy of the record is made evidence by this code or other statute.

5. When the original consists of numerous accounts or other documents, which cannot be examined in Court without great loss of time, and the evidence sought from them is only the general result of the whole.

In the cases mentioned in subdivisions three and four, a copy of the original, or of the record, must be produced; in those mentioned in subdivisions one and two, either a copy or oral evidence of the contents."

No foundation was laid, nor was any testimony introduced which would bring into operation any of the exceptions hereinabove set forth in said Code section. Respondent was never requested to produce these documents.

None of the pre-trial discovery procedures were followed, nor was any reason given why none of these motions or procedures were not pressed by appellant after Judge Erskine had made his order dated July 24, 1950. Under Rule 26 (a) of the Rules of Civil Procedure, appellant could have taken the deposition of any of the officers or employees of the defendant, Viking Automatic Sprinkler Co., either for discovery or to use as evidence in the trial of the case. Under Rule 45 (b) of the Rules of Civil Procedure, any applications for insurance or any policies of insurance held by the Viking Co. could have been subpoenaed at the time of the taking of the deposition of any of the employees and any other documents in the possession of the Viking Co. that would aid in the interpretation and the intent of the parties insofar as the sub-

ject contract was concerned, could have been subpoenaed. Under Rule 34 of the Rules of Civil Procedure, appellant could have secured an Order of Court requiring the Viking Co. to produce any material documents so that the plaintiff could examine, copy or photograph the same. Said documents or copies thereof would then have been available to have been introduced into evidence at the time of the trial if they were material and there was an endorsement or any language in any of the documents which would assist the Court in determining the intent of the parties and interpreting the contract in question. All of these procedures were followed by respondent.

In the absence of such procedure and proper offer of proof, the Court was justified in sustaining the objections of the respondent and there is nothing in the record and nothing before the Court to indicate whether the questions asked by Mr. Healy would have developed any material evidence or any admissible evidence. Although all the discovery procedures have been liberalized to permit fishing for evidence, such procedure certainly is improper in the middle of a trial.

IV.

APPELLANT ASSERTS THAT THE EVIDENCE MUST BE VIEWED MOST FAVORABLY TO IT ON THIS APPEAL.

This assertion is true but the only evidence appellant relies upon to prove that Viking Company intended to indemnify the Austin Company against its

own negligence is the insurance provisions of the contract. The fact that Viking Company was required to carry certain types of insurance certainly could not lead to the conclusion that Viking Company intended to indemnify the Austin Co. against its own negligence. The fact that Austin Co. carried insurance and also required Viking Co. to do so clearly shows that it was the intent of both parties to take care of their own obligations and any liabilities they might incur as a result of accidents.

The insurance provisions of the contract can further be reasonably and logically explained by referring to good business practice of any large business concern or contractor. The Austin Co. had a multi-million dollar construction contract and tremendous obligations to carry in the huge construction project that it had undertaken. Of necessity, it sub-let much of the work and if its subcontractors were unable to perform their portion of the work the general contractor, the Austin Company, certainly would have sustained substantial losses. Therefore, it was to its interest that none of the subcontractors were prevented from completing their work due to having large judgments rendered against them, as they might be unable to pay the same and have been forced into bankruptcy. The Austin Company could not take out insurance in its own name that would protect it from judgments being rendered against subcontractors covering liability claims for damages. However, this was a cost-plus contract and by requiring the subcontractors to carry insurance and then paying the premiums as part of the cost, the Austin Company fully protected itself.

This interpretation is further substantiated by the fact that although most construction contracts require the posting of a performance bond or surety bond by the contractor or sub-contractor, there was no requirement that the Viking Company procure such a bond in the present contract. Respondent feels that this is a very significant and strong point in assisting in the interpretation of the contract and indicating that the insurance coverage required was a substitute for the performance bond. It is to be noted in the case of *Southern Pacific Co. v. Fellows*, 22 C.A. (2d) 87, 71 P. (2d) 75, which is the only case cited by appellant in which recovery had been made under a so-called Hold-Harmless Agreement between the owner and a contractor, that the contract not only included a Hold-Harmless Agreement and provisions of insurance, but also had a provision requiring the contractor to post a performance or surety bond.

Under the interpretation of the contract contended for by appellant, the Viking Company would have been obligated to defend any action brought by any stranger against the Austin Company for personal injuries or damages if the same arose out of the negligence of the Austin Company on any of the work that they or any of their sub-contractors were performing in connection with the master contract. This is the only possible conclusion that could be reached if the interpretation of appellant is accepted.

Furthermore, the very fact that this was a cost-plus contract indicates that there was no intention to reimburse the Austin Company for its own negligence as

such a result under the provisions of the contract would be ridiculous. If the Viking Company were forced to pay a judgment to one of its employees or to a stranger on the basis of the so-called Hold-Harmless Agreement, it could then bill the Austin Company for its expenditures plus 10% for overhead and 8% for profit.

CONCLUSION.

Appellant's only specification of error (Appellant's Brief 4) is that the Court did not permit the appellant to attempt to prove through Samuel A. Johnson that the Viking Company had a contract of public liability insurance with a contractual endorsement on it.

The ruling of the trial Court was proper in that:

1. No proper foundation was laid.

2. It was not the best evidence.

   a. No attempt was made to show why the best evidence was not offered.

Therefore, it is respectfully submitted that the judgment of the trial Court should be sustained.

Dated, San Francisco, California,
August 1, 1951.

BOYD, TAYLOR & REYNOLDS,
By ROBERT F. REYNOLDS,
Attorneys for Appellee.

No. 12,889

IN THE

United States Court of Appeals

For the Ninth Circuit

GENERAL ACCIDENT FIRE AND LIFE ASSURANCE CORPORATION, LTD. (a corporation),

Appellant,

vs.

VIKING AUTOMATIC SPRINKLER COMPANY (a corporation),

Appellee.

Appeal from the United States District Court, Northern District of California, Southern Division.

APPELLANT'S CLOSING BRIEF.

HEALY AND WALCOM,
68 Post Street, San Francisco 4, California,
Attorneys for Appellant.

No. 12,889

IN THE

United States Court of Appeals

For the Ninth Circuit

General Accident Fire and Life Assurance Corporation, Ltd. (a corporation),

Appellant,

vs.

Viking Automatic Sprinkler Company (a corporation),

Appellee.

Appeal from the United States District Court, Northern District of California, Southern Division.

APPELLANT'S CLOSING BRIEF.

We have examined the brief presented by appellee. It is divided into four parts. It does not appear that any of the points made are well taken. Since this record is short and since we have stated our position in our opening brief, we will but briefly comment upon each of the points made by appellee. The discussion will be in the same order as presented in appellee's brief.

I.

Appellee acknowledges the statement of the rule as we have expressed it in our opening brief, but contends that since there was not an *express* statement in the indemnity agreement concerning the negligence of the Austin Company that there was no such coverage. It needs no citation of authority for the proposition that to make a binding contract no particular form or particular words need be employed. The intent of the parties is to be gathered from a fair construction of the language used. Paragraph 7 of the contract provided that the Viking Company was to indemnify the Austin Company "against all claims for damages." There is no broader, more universal or embrasive word in the English language than "all." All damages means just what it says, including damages arising from the negligence of the Austin Company.

Judge Erskine was of the opinion that the contract contained a "latent ambiguity * * *" which "required the taking of testimony." Therefore, as Judge Erskine pointed out, if there were some ambiguities the appellant should have been allowed to produce the proffered evidence to throw light upon the true intent of the parties.

II.

Excerpts are taken from the record quoting the statements of Mr. Healy who was presenting the matter for appellant in the trial court. Such statements

are taken out of context and are misleading. Reference is made to the entire colloquy by the Court and counsel and attention particularly directed to the discussion at page 45 of the record. It was appellant's position that a proper interpretation of the contract would of necessity lead to a directed verdict in favor of the plaintiff:

> "Mr. Healy. I think it is. I think, your Honor, if we prove that, as I am certain we can, I think your Honor would have to direct the Jury to render a verdict for the plaintiff, I really think so." (R. 45.)

The Court not agreeing with appellant, appellant was then required in line with Judge Erskine's view to explain any ambiguity.

III.

Appellee claims that there was no proper foundation laid and there was a violation of the best evidence rule concerning the proffered evidence of insurance. This point is without any substance whatsoever. The Court well knew what was being offered and ruled that it was immaterial. The objection to the evidence was not sustained on any technical ground but went to the heart and merits of the case. The Court specifically stated:

> "Mr. Healy. I ask permission to question that man upon his policy. I think you can take that outside of the presence of the Jury.
>
> The Court. To save your record in the matter, I will hold that that is immaterial, and I will

sustain the objection to that testimony as to the purpose for which it is sought.

Mr. Healy. It will be understood that I have asked the question clearly, we all understand the force of it, and it was argued.

The Court. It will be understood that you have asked the same question again that you asked previously, and that I sustained the objection on the ground that that is immaterial to the resolution of this question.

Mr. Healy. Very well." (R. 129.)

IV.

An analysis of the last point made by appellee only serves to demonstrate the soundness of appellant's position. As we pointed out in our opening brief, page 15 et cetera, this was a cost-plus, a fee contract. The cost would be ultimately borne by the Austin Company. The parties entered into an elaborate scheme for insurance. Austin Company could not be held liable for the torts or wrongdoings of its subcontractor Viking Company. It is inconsistent with good business practice and altogether illogical to have required the carrying of such insurance if the same were meaningless. Reference is made to pages 13-19 of appellant's opening brief for further discussion of this point.

CONCLUSION.

It is respectfully submitted that the Court erred in refusing to allow appellant to question and prove by the witness Johnson that appellee had a contract of public liability insurance with a contractual endorsement; and that the Court erred in taking the case from the jury and dismissing the action. Reversible error having been committed the judgment should be reversed and a new trial granted.

Dated, San Francisco, California,
August 31, 1951.

Respectfully submitted,
HEALY AND WALCOM,
By JOHN J. HEALY,
Attorneys for Appellant.

No. 12891

United States Court of Appeals

for the Ninth Circuit.

UNITED STATES OF AMERICA,

Appellant,

vs.

KWAN SHUN YUE,

Appellee.

Transcript of Record

Appeal from the United States District Court,
Southern District of California,
Central Division.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

No. 12891

United States Court of Appeals for the Ninth Circuit.

UNITED STATES OF AMERICA,

Appellant,

vs.

KWAN SHUN YUE,

Appellee.

Transcript of Record

Appeal from the United States District Court, Southern District of California, Central Division.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF ATTORNEYS

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For Appellee:

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In the United States District Court in and for the Southern District of California, Central Division

No. 131990

In the Matter of

The Petition of KWAN SHUN YUE, to Be Admitted a Citizen of the UNITED STATES OF AMERICA

AGREED STATEMENT OF FACTS ON APPEAL

The above-entitled matter came before the Court on the motion of the United States of America for an order denying the petition of Kwan Shun Yue, a national of China, for naturalization.

The petitioner applied for admission to the United States at Seattle, Washington, July 20, 1924, in possession of a certificate, as a treaty merchant, issued under Section 6 of the Chinese Exclusion Act, (22 Stats. 58, Act of May 6, 1882, as amended). The certificate had been visaed by the American Consul at Hong Kong, June 27, 1924, and petitioner sailed from China about July 2, 1924. On September 9, 1924, the Board of Review of the Department of Labor ordered the subject excluded on the ground that he was not coming to the United States as a bona fide merchant under and in pursuance of any treaty of commerce and navigation.

Habeas corpus proceedings were instituted in behalf of petitioner and others in the District Court for the Western District of Washington, and the writ was granted. The judgment of the District

Court was affirmed by the United [2*] States Court of Appeals for the Ninth Circuit on November 13, 1925, in the case of Weedin v. Wong Tat Hing, et al., 6 F. (2d) 201.

A certificate of arrival, showing petitioner's admission as a treaty merchant under Section 3(6) of the Immigration Act of 1924 was filed with the petition in this proceeding for naturalization, a copy of which is attached hereto, marked Exhibit "A-1" and made a part hereof by reference.

Said motion came on for hearing before the Honorable James M. Carter, Judge of the said District Court, on or about the 29th day of December, 1950, petitioner appearing by Benjamin W. Henderson, his attorney, and the United States of America appearing through its Immigration and Naturalization Service, of the Department of Justice by Lloyd H. Garner, Naturalization Examiner.

The Court thereupon denied the motion of the United States for the denial of the petition and the Court made a Minute Order and rendered a written opinion adopting the Findings of Fact, Conclusions of Law and Recommendations of the Designated Examiner, except as modified by said opinion, and the Court made its formal order admitting the petitioner to citizenship on January 5, 1951.

A copy of the Findings of Fact, Conclusions of Law and Recommendations of the Designated Examiner is attached hereto and marked Exhibit "A" and made a part hereof by reference. A copy of the

***Page numbering appearing at foot of page of original Certified Transcript of Record.**

Minute Order made by the Court on December 29, 1950, is attached hereto, marked Exhibit "B" and made a part hereof by reference. The written Opinion of the Court is attached hereto, marked Exhibit "C" and made a part hereof by reference. A copy of the formal Order admitting the petitioner to citizenship, which is the Order appealed from, is attached hereto, marked Exhibit "D" and made a part hereof by reference. The Notice of Appeal herein was filed on February 27, 1951, and a copy of said Notice is attached hereto, marked Exhibit "E" and made a part hereof by reference.

The points to be relied upon by appellant are:

(1) That the Court erred in holding that petitioner established a lawful admission to the United States as an immigrant for permanent residence; and

(2) That the Court erred in exempting petitioner from filing with the petition a valid certificate showing the date, place and manner of petitioner's arrival in the United States. [3]

It is hereby agreed by the parties hereto, through their respective counsel, that the foregoing is a full and true statement of the above-entitled case, showing how the questions arose and were decided by the above-entitled Court.

Dated: March 30, 1951.

/s/ BENJAMIN W. HENDERSON,
Attorney for Petitioner.

ERNEST A. TOLIN,
United States Attorney.

CLYDE C. DOWNING,
Assistant U. S. Attorney,
Chief, Civil Division.

/s/ ROBERT K. GREAN,
Assistant U. S. Attorney,
Attorneys for Respondent.

ORDER APPROVING AGREED STATEMENT

The foregoing Agreed Statement of the case, prepared pursuant to Rule 76 of the Federal Rules of Civil Procedure, is hereby approved, and the Clerk is instructed to attach a copy hereto of the Certificate of Arrival, No. 1600-K-5444, as an exhibit.

Dated this 2nd day of April, 1951.

/s/ JAMES M. CARTER,
U. S. District Judge. [4]

In the United States Court of Appeals
for the Ninth Circuit

THE UNITED STATES OF AMERICA,
Respondent and Appellant,

vs.

KWAN SHUN YUE,
Petitioner and Respondent.

STATEMENT OF GROUNDS OF APPEAL

An agreed statement of facts on appeal having been heretofore filed in this cause, respondent and appellant now hereby set forth its grounds for appeal:

I.

That the Court erred in holding that petitioner's admission to the United States as a treaty merchant under Section 3(6) of the Immigration Act of 1924 was admission to the United States for permanent residence for naturalization purposes.

II.

That the Court erred in holding that the petitioner, who had not filed with his petition a certificate of arrival showing admission to the United States as an immigrant for permanent residence, was exempt from the necessity of filing such certificate of arrival.

Dated at Los Angeles, California, this 30th day of March, 1951.

ERNEST A. TOLIN,
United States Attorney.

CLYDE C. DOWNING,
Assistant U. S. Attorney,
Chief, Civil Division.

ROBERT K. GREAN,
Assistant U. S. Attorney. [5]

Exhibit A

In the United States District Court, Southern District of California, Central Division

No. 131990

In the Matter of

The Petition of KWAN SHUN YUE to Be Admitted a Citizen of the UNITED STATES OF AMERICA

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND RECOMMENDATION OF THE DESIGNATED NATURALIZATION EXAMINER

To the Honorable the Judges of the United States District Court, for the Southern District of California:

I.

The undersigned, duly designated pursuant to Section 333 of the Nationality Act of 1940, 8 U.S.C.

733, to conduct preliminary hearings on petitioners for naturalization, respectfully reports that the above-named petitioner, a native and national of China, age 56 years, who has lived in the United States continuously since his lawful admission on November 13, 1925, filed the petition for naturalization mentioned above on June 2, 1947, claiming the exemptions of Section 310(b) of the Nationality Act of 1940.

The question presented is whether the petitioner may be regarded as having been lawfully admitted for permanent residence for naturalization purposes.

II.

On June 2, 1947, following the filing of the petition for naturalization, petitioner and his verifying witnesses were accorded a preliminary hearing at which time petitioner testified under oath in part as follows: That he married a Chinese woman in China before [6] migrating to the United States, leaving her there; that he heard thru relatives about 1927 that she had died, leaving no children; that in 1932 he was "married" in accordance with the Chinese ritual but without compliance with California procedural requirements in Los Angeles, and has three children born of that union; that his "wife" had never been previously married; that on March 30, 1947, he was again married to the same woman in accordance with California Civil Code Section 79; that his wife is a citizen of the United States by birth in Los Angeles, California, and that they are still living together; that he has never been

arrested except by citations for minor traffic violations; that he entered the United States at Seattle, Washington, on November 13, 1925, as a treaty merchant, intending to reside here permanently, and that he has remained in the United States continuously since that admission; that his present occupation is grocery store proprietor.

III.

The record discloses that the petitioner applied for admission to the United States at Seattle, Wn., on July 20, 1924, in possession of a certificate as a treaty merchant issued under section 6 of the Chinese Exclusion Act (22 Stat. L. 58) (Act of May 6, 1882, as amended). On September 9, 1924, the Board of Review of the Department of Labor ordered that the subject be excluded in that he was not coming to the United States as a bona fide merchant under and in pursuance of any treaty of commerce and navigation. His Section 6 certificate had been visaed by the American Consul at Hong Kong on June 27, 1924, and he had sailed from China about July 2, 1924. Habeas corpus proceedings were instituted in his behalf and the U. S. District Court for the Western District of Washington, Northern Division, granted the writ on July 13, 1925. The judgment of the District Court was affirmed by the U. S. Court of Appeals for the Ninth Circuit, November 13, 1925 (Wong Fat Hing, et al., 6 F. 2d 201.) A certificate of arrival, qualified to show the true character of his admission as a treaty merchant under section 3(6) of the Immi-

gration Act of 1924 has been filed with the petition. [7]

The issue in the instant case should not be confused with recent decisions holding that Chinese persons who have been admitted to the United States subsequent to July 1, 1924, as minor children of Chinese merchants who had been admitted to the United States prior to July 1, 1924, could be considered as having a lawful admission for permanent residence for naturalization purposes (Wong Choon Hoi, 71 F. Supp. 160, appeal dismissed 164 F. 2d 699, 9th Cir., 1947; Petition of Chi Yan Cham Louie, 70 F. Supp. 493, app. dism. 166 F. 2d 15, 9th Cir. 1947; Pet'n of David Jow Gin, USD Court, Chicago, #323406, app. dism. 7th Cir. 6/9/49, 175 F. 2d 299; and Petition of Yung Poy, 177 F. 2d 144). In those cases the fathers had been admitted prior to July 1, 1924, and were considered as having a lawful admission for permanent residence. In the instant case the petitioner's first arrival in the United States was after July 1, 1924. He was admitted on his own status as a merchant and not on the basis of any rights derived from a person who had previously been admitted for permanent residence.

The instant petitioner's right to enter the United States was predicated essentially upon Article II of the Treaty of Commerce and Navigation with China, dated November 17, 1880, which provides in part as follows:

> Chinese subjects, whether proceeding to the United States as teachers, students, merchants or from curiosity, together with their body and

> household servants, and Chinese laborers who are now in the United States shall be allowed to go and come of their own free will and accord, and shall be accorded all the rights, privileges, immunities, and exemptions which are accorded to the citizens and subjects of the most favored nation.

Since the instant petitioner entered the United States after July 1, 1924, his status must also be evaluated in the light of the Immigration Act of 1924, 43 Stat. 153, which became effective on July 1, 1924. It is not disputed that Chinese merchants and their families who entered the United States prior to July 1, 1924, may be regarded as admitted for permanent residence, as neither the Treaty nor the Act of May 6, 1882, as amended by the Act of July 5, 1884, then in effect, contained any limitation restricting the term or nature of their stay [8] in the United States. However, in enacting the Immigration Act of 1924, Congress made drastic revisions in the earlier patterns of regulation. All aliens seeking to enter the United States were designated as immigrants, except the groups classified as non-immigrants in Section 3, 8 U.S.C. 203. Immigrants were required to obtain immigration visas, and, except for those classified as non-quota immigrants, were subject to quote restrictions. [Sections 4, 11, 13(a), Immigration Act of 1924, 8 U.S.C. 204, 211, 213(a)]. Section 3(6) of the 1924 Act, 8 U.S.C. 203(6), classified as a non-immigrant, "an alien entitled to enter the United States solely to

carry on trade under and in pursuance of the provisions of a present existing treaty of commerce and navigation."

In enacting section 3(6) of the 1924 Act, Congress did not seek to nullify existing treaties. On the contrary, the legislative history indicates that Section 3(6) was designated to safeguard treaty obligations. (House Rep. 360, 68th Cong., 1st Sess.). But in limiting the terms of admission, Congress actually was effectuating the purpose of the treaties, which sought merely to enable nationals of the contracting nations to enter for the purposes of trade, and not for permanent settlement. This aim seems clearly shown in the 1880 treaty with China, which lists merchants with traders, students and travelers for curiosity—clearly not permanent settlers—and authorized the excepted categories "to go and come of their own free will and accord." This hardly appears to have envisioned a formula for permanent settlement. Congress in the 1924 Act, therefore, deliberately excluded the treaty merchants from its designation as immigrants—those coming for permanent residence—and listed them with the non-immigrants—whose sojourn was limited in period or purpose. It can hardly be disputed, therefore, that treaty merchants, including those who entered under the treaty with China, admitted to the United States after June 30, 1924, are not classed as permanent residents for naturalization purposes.

In the case of In re Pezzi, 29 F. 2d 999, DC Calif. 1928, there came before the Court a petition for naturalization of a woman [9] who had entered the

United States in 1925 as a non-immigrant alien. In 1926 she was granted permission by the Department of Labor to remain in the United States indefinitely, so long as her husband maintained his status as a treaty merchant. The record showed that the petitioner was admitted to the United States under Section 3 (2) of the Immigration Act of 1924 and that her status was later changed to that of the wife of a treaty merchant under Section 3(6) of that Act. The petitioner had resided in the United States for the statutory period and urged that she intended to remain permanently in the United States; that, consequently, she was lawfully admitted to the United States for permanent residence and was therefore eligible for naturalization. The Court denied the petition, and held, at page 1001:

> In order to be entitled to naturalization, an alien must establish lawful entry into the United States as an immigrant, with intent to remain in the United States permanently. An alien who enters the United States without inspection and admission as an immigrant for permanent residence is not entitled to naturalization under our statutes. Kaplan vs. Tod, 267 US 228, 45 S.Ct. 257, 69 L. Ed. 585; In re Kempson, et al., 14 F. 2d 668; In re Jensen, 11 F. 2d 414; Ex Parte Marchant, et al., 3 F. 2d 695.

The Court further said, at page 1002:

> Has the petitioner here met the requirements of the law? I think not. The petitioner has no status in the United States, other than being

the wife of her husband. Her husband's status is defined by the provisions of Sec. 3 of the Quota Act of 1924 and the treaty of commerce and navigation between the United States and Italy of 1871 (17 Stat. 845). This treaty defines the status of "Italian citizens in the United States and citizens of the United States in Italy." Article 1. It clearly contemplates the temporary stay of the merchants of one country in the territory of the other. It accentuates the fact that the citizen of the one country is entitled to certain rights and privileges in the other country, including the privilege of being accompanied by wife, minor children, servants, etc., solely and wholly because such citizen of one country is in the other country, temporarily, and for no other purpose than to carry on trade. There is not the slightest thought involved in the language of the treaty that the citizen of one country, residing in the other country as a treaty merchant, is laying the foundation for becoming a citizen of the other. Everything in the treaty negatives that thought.

Neither the petitioner nor her husband could have been admitted, under the credentials they carried, as immigrants or as persons coming for the purpose of permanently residing in the United States. They were admitted specifically as non-immigrant aliens, and specifically under the language of the Quota Law of 1924, as "aliens entitled to enter * * * [10] solely to carry on trade under and in pursuance of the

> provisions of a present existing treaty of commerce and navigation." 8 U.S.C. 203. The word "solely" there means exactly what it says.

The Court referred to the argument of counsel as to the petitioner's rights under the treaty with Italy, and said:

> The treaty rights are clear and unambiguous, and are limited solely to the right of all the freedom of movement and protection under our laws that are essential to the carrying on of trade as a citizen of a friendly nation, really moving in this country under the flag of his own country and being here for temporary purposes. The Immigration Quota Act of 1924 sharpens this doctrine of the rights of a treaty merchant and is wholly in harmony with it. Should it be true that the Immigration Act contains additional limitations, that makes the status of the treaty merchants all the more pronounced.

The Court consequently rules that the petitioner had not complied with the requirements of the naturalization laws as to an entry into the United States for permanent residence, and that therefore her petition must be denied. It should be noted that the treaty that was under consideration in the Pezzi case, the treaty with Italy of February 26, 1871, specifically provided that the citizens of the respective countries parties to the treaty would have the "liberty to sojourn and reside in all parts whatever of said territories," referring to the territories

of the countries. They were also given the right to enjoy the privileges and rights of natives of the countries and to carry on trade and commerce with restriction (17 Stat. 845). Likewise, under Article II of the treaty citizens of each of the countries had the right to travel in the states and territories of the other country.

The similarity between the foregoing case and the present issue cannot lightly be disregarded. In both cases the petitioners were admitted to the United States subsequent to the passage of the Immigration Act of 1924; in both cases the status of the petitioners was that of a non-immigrant under section 3(6) of that Act, with the right to remain indefinitely in the United States; in both cases the immigration status of the petitioners was based upon a treaty with a foreign country relating to trade and commerce. No good reason, in fact or law, can be discerned why the rule in the case of In re Pezzi [11] should not apply to the present issue particularly since the cited case is not unique but represents a theory of law which has been uniformly followed.

In the case of Subhi Mustafa Sadi v. U. S., 48 F. 2d 1040 (2d Cir. 1931), a petition for naturalization was filed by a person who had entered the United States on August 1, 1923, as a non-quota immigrant, student, under the Immigration Act of 1921. Deportation proceedings were instituted against him and upon application for habeas corpus such proceedings were dismissed on the ground that he was exempt from the quota and not subject to

deportation. In connection with his petition for naturalization, the subject argued that the order sustaining the writ of habeas corpus fixed his status as an alien admitted to the United States for permanent residence. The Court denied the petition for naturalization, and stated:

> This appears to be a case of unusual hardship, but the status above quoted explicitly forecloses any right to the appellant to be admitted to citizenship on his pending petition. We do not now undertake to determine whether or not he was entitled to entry for permanent residence at the time he was admitted at Boston. The fact remains that he was not so admitted, and while that record stands he cannot comply with the statute requiring his lawful entry for permanent residence to be established. See In re Weig, 30 F. 2d 418.
>
> It is urged that the order sustaining the writ of habeas corpus fixed his status as that of an alien admitted for permanent residence. To the extent that it had the effect of preventing his deportation upon the warrant which had been issued, it did, of course, lend some color of permanence to his stay, in that he successfully withstood that attempt to deport him, but it did not change in any respect the terms and conditions of his original entry. It simply gave effect to the right he then possessed to remain in this country notwithstanding the order of deportation which had been issued. In respect

> to his ability to lay an essential foundation for his admission to citizenship, he stands in exactly the same situation he would have been had no warrant for his deportation been issued and no writ of habeas corpus sustained in his behalf.

Upon rehearing the Court again said, at page 1041:

> To be sure, his discharge on the writ of habeas corpus did, as we said before, establish his right to remain in this country in spite of the effort then being made to deport him, but, because it did not necessarily require proof that he had been admitted for permanent residence, it now is of no aid to him when he must show that fact as a condition precedent to the validity of his petition for naturalization. See U. S. ex rel. Gentile v. Day, 25 F. 2d 717.

Here again we see a decision by an appellate court to the effect [12] that the mere fact that a petitioner for naturalization is not deportable, does not create a lawful admission for permanent residence for naturalization purposes. A similar decision was made in Warblow v. U. S., 134 F. 2d 791 (2d Cir. 1943), where the Court in ruling upon the question of lawful continuous residence required of a petitioner for naturalization, said, at page 792:

> If what is a legal admission for permanent residence for the purposes of naturalization is to be determined in accordance with the immigration laws, it is clear that the appellant had not resided in this country for at least two

> years immediately preceding the date of his petition in pursuance of a legal admission for permanent residence.

The Court further said:

> When aliens enter the United States they are lawfully here for permanent residence only if they have complied with the requirements of the laws of this country applicable to the incoming of such people. Those laws are the immigration laws and so far as we know, or the appellant has been able to point out, are the only laws under which the right, or the contrary, of an alien to come here and stay may be determined. When the nature of his residence in the United States has been so determined, his status under the naturalization laws is established so far as that feature is concerned. They set up no different general standards of their own in that regard.

It can be seen, therefore, that insofar as the decisions of the courts are concerned, it is the established rule that a petitioner for naturalization must establish a lawful admission to the United States for permanent residence as an immigrant. The mere fact that the alien is not deportable does not create a status of lawful permanent residence in the United States, nor does a lawful admission as a non-immigrant constitute a basis for a petition for naturalization.

On December 17, 1943, Congress passed the Chinese Exclusion Repeal Act (57 Stat. 600). Sec-

tion 3 of the Statute directed that Chinese persons or persons of Chinese descent be added to the racial groups that are eligible for naturalization. In enacting this legislation, Congress did not contemplate that all Chinese persons in the United States should thereby be naturalized. On the contrary, Congress merely put the Chinese on a parity with other racial groups and insisted that they qualify for naturalization on the same terms [13] as all other applicants. This design was specifically asserted by the Congressional Committees which considered the legislation, in the following language (House Rep. 732; Sen. Tep. 535, 78th Congr., 1st Sess.):

> The number of Chinese who will actually be made eligible for naturalization under this section is negligible. There are approximately 45,000 alien Chinese persons in the United States (continental, territorial, and insular). However, a large number of these Chinese have never been admitted to the United States for lawful permanent residence, which is a condition precedent to naturalization and, therefore, many of this number could not be eligible for naturalization, not because of racial disability, but because they cannot meet existing statutory requirements of the law. The number of Chinese who will be made eligible in the future, in addition to those already here, will of necessity be very small because the quota for China is limited to 105 per annum, as provided for in Section 2 of this bill.

It is concluded that Congress contemplated granting the privilege of naturalization only to those Chinese aliens who were lawfully admitted to the United States for permanent residence as immigrants. As this petitioner was admitted as a nonimmigrant, he is not considered as having been lawfully admitted to the United States for permanent residence for naturalization purposes, and the certificate of arrival which forms the basis of his petition for naturalization is not a valid certificate of arrival for naturalization purposes.

IV.

Pursuant to the provisions of Section 333 of the Nationality Act of 1940, 8 U.S.C. 333, I hereby make the following findings of fact and conclusions of law:

Findings of Fact

(a) That the petitioner is an alien, and filed a petition for naturalization on June 2, 1947;

(b) That the petitioner was admitted to the United States on November 13, 1925, pursuant to the provisions of Section 3(6) of the Immigration Act of 1924, and has resided in the United States continuously since that date;

(c) That petitioner has not filed with his petition a certificate of arrival showing admission to the United States as an [14] immigrant for permanent residence; and

(d) That petitioner has not established facts showing that he is exempt from the necessity of filing such certificate of arrival.

Conclusions of Law

(a) That the petitioner has failed to establish lawful admission to the United States as an immigrant for permanent residence;

(b) That a valid certificate of arrival, showing the date, place and manner of arrival in the United States, as required or contemplated by Section 332 of the Nationality Act of 1940, 8 U.S.C. 732, was not filed with the petition, and petitioner is not exempt from such procedural requirement; and

(c) That petitioner may not be naturalized.

V.

I therefore recommend that the petition of Kwan Shun Yue for naturalization be denied on the grounds that (a) petitioner has failed to establish lawful admission to the United States for permanent residence and (b) that a valid certificate of arrival was not filed with the petition, and petitioner has not established exemption from such requirement.

Respectfully submitted,

LLOYD H. GARNER,
U. S. Naturalization
Examiner.

August 21, 1950, Los Angeles, Calif.

U. S. Department of Justice
Immigration and Naturalization Service
Rev. 10-1-44

No. 1600-K-5444

Certificate of Arrival

I hereby Certify that the immigration records show that the alien named below arrived at the port, on the date and in the manner shown, and was lawfully admitted to the United States of America under Section 3(6) of the Immigration Act of 1924.

Name: Kwan Shun Yue.

Port of entry: Seattle, Washington.

Date: Nov. 13, 1925.

Manner of arrival: SS President Grant.

I Further Certify that this certificate of arrival is issued under authority of and in conformity with the provisions of the Nationality Act of 1940 solely for the use of the alien herein named and only for naturalization purposes.

In Witness Whereof this Certificate of Arrival is issued May 6, 1947.

[Seal] /s/ UGO CARUSE,
Commissioner. [15]

Exhibit B

At a stated term, to wit: The September Term A. D. 1950, of the District Court of the United States of America, within and for the Central Division of the Southern District of California, held at the Court Room thereof, in the City of Los Angeles on Friday, the 29th day of December, in the year of our Lord one thousand nine hundred and fifty.

Present: The Honorable James M. Carter,
District Judge.

[Title of Cause.]

MINUTE ORDER

This matter having been duly heard and submitted, and the Court having duly considered the matter, the Court now hands down its Opinion, which is filed; and, pursuant to said Opinion, it is ordered that the motion of the United States for the denial of the petition be denied, and that the petition for citizenship be granted. The Court adopts the findings of fact and conclusions of law of the Examiner, except as they are modified by the Opinion; counsel for the government will present formal order for Court's signature within 10 days, and will arrange with opposing counsel and the Court to have the petitioner personally present in open court at that time for the purpose of administering the oath of allegiance and such further proceedings as are required by law. [16]

Exhibit C

In the District Court of the United States, Southern District of California, Central Division

No. 131990

In the Matter of
The Petition of KWAN SHUN YUE, to Be Admitted a Citizen of the UNITED STATES OF AMERICA

OPINION

BENJAMIN W. HENDERSON,
308 Pershing Square Building,
448 S. Hill Street,
Los Angeles, California,
MAdison 2766,
Attorney for Petitioner.

LLOYD H. GARNER,
Naturalization Examiner,
Immigration & Naturalization Service,
458 S. Spring Street,
Los Angeles, California,
MUtual 1281,
For the United States.

Carter, James M., District Judge.

This matter comes before the court on the motion of the United States of America for an order denying the petition of Kwan Shun Yue, a National of

China, for naturalization, on the ground (1) that petitioner has failed to establish a lawful admission to the United States as an immigrant for permanent residence, and (2) on the further ground that [17] a valid certificate showing the date, place and manner of petitioner's arrival in the United States, was not filed with the petition, and that petitioner has not established exemption from such requirement.

The particular question to be decided is the effect of the Immigration Act of May 26, 1924, c. 190 (43 Stats. 1531) and Sec. 3 thereof (8 U.S.C. §203) which became effective July 1, 1924, on Chinese treaty merchants entering the United States after the effective date of that statute, when read in connection with the treaty between this country and China, of November, 1880[1] (22 Stats. 8261 and the subsequent treaty of March, 1894[2] (28 Stats. 1210).

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[1]The pertinent section of Article II of the Treaty reads as follows: "Chinese subjects, whether proceeding to the United States as teachers, students, merchants or from curiosity, together with their body and household servants, and Chinese laborers who are now in the United States, shall be allowed to go and come of their own free will and accord, and shall be accorded all the rights, privileges, immunities and exemptions which are accorded to the citizens and subjects of the most favored nation."

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[2]The pertinent section of the Treaty is Article III, which reads as follows: "The provisions of this convention shall not affect the right at present enjoyed of Chinese subjects, being officials, teachers, students, merchants or travellers for curiosity or pleasure,

The Facts

The facts, as found by the designated Examiner, show that petitioner applied for admission to the United States at Seattle, Washington, July 20, 1924, in possession of a certificate, as a treaty merchant, issued under Section 6 [18] of the Chinese Exclusion Act (22 Stats. 58, Act of May 6, 1882, as amended). The certificate had been visaed by the American Consul at Hong Kong, June 27, 1924. On September 9, 1924, the Board of Review of the Department of Labor ordered the subject excluded on the ground that he was not coming to the United States as a bona fide merchant under and in pursuance of any treaty of commerce and navigation.

Habeas corpus proceedings were instituted in behalf of petitioner and others in the District Court for the Western District of Washington, and the writ was granted. The judgment of the District Court was affirmed by the United States Court of Appeals for the Ninth Circuit on November 13, 1925, in the case of Weedin v. Wong Tat Hing, et al., 6 F. (2d) 201.

The findings of the designated Naturalization Examiner in the present proceeding for naturalization, contains the statement, "A certificate of ar-

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but not laborers, of coming to the United States and residing therein. To entitle such Chinese subjects as are above described to admission into the United States, they may produce a certificate from their government or the government where they last resided vised by the diplomatic or consular representative of the United States in the country or port whence they depart * * *" (Emphasis added.)

rival, qualified to show the true character of his admission as a treaty merchant under Section 3(6) of the Immigration Act of 1924 has been filed with the petition." (8 U.S. Code §203(6) 1).

The Law

Petitions for the naturalization of Chinese aliens who as children of treaty merchants, entered the United States after July 1, 1924, but whose fathers, the treaty merchants, entered the United States before July 1, 1924, have been before the courts and the cases have uniformly held that the admission of the treaty merchant (the father) prior to July 1, 1924, made legal the subsequent admission of the children to the United States, and that the child's residence was of such a permanent character as to be sufficient for naturalization purposes. Petition of Wong Choon Hoi (C.C.S.D.Cal.), 71 F. Supp. 160; appeal dismissed 164 F.(2d) [19] 696, on the ground that the appellant was not a proper party. In re Chi Yan Cham Louie, (D.C.W.D. Wash.) 70 F. Supp. 493; appeal dismissed 166 F.(2d) 15, on the ground appellant was not a proper party. In re Jow Gin, (7 Cir.) 175 F.(2d) 299; United States v. Yung Poy (9 Cir.) 177 F.(2d) 144.

The Government now urges, however, that because of the provisions of the Immigration Act of May 26, 1924, (43 Stats. 153) Title 8, U.S.C., Sec. 203[3]

[3]"§203. Immigrant defined. When used in this chapter the term 'immigrant' means any alien departing from any place outside the United States destined for the United States, except * * * (6) an

that the Congress, in substance, created two classes of people entering the United States, immigrants and non-immigrants, and the Congress, in the Act, deliberately excluded treaty merchants from the designation as immigrants, (i.e. those coming for permanent residences) and listed them with the non-immigrants, and that therefore petitioner, arriving after July 1, 1924, was not admitted to the United States for permanent residence and cannot be naturalized.

It is elemental that Congress, by statute, cannot vary or diminish rights created under a treaty, and the courts have consistently held that the various immigration acts passed after the treaties with China in 1880 and 1884, do not abrogate, nullify or abridge the rights of Chinese to enter pursuant thereto. Haff v. Yung Poy, (9 Cir. 1933) 68 F.(2d) 203.

We choose to rely particularly on the decision by Judge Mathes in the petition of Wong Choon Hoi, 71 F. Supp. [20] 160, supra. It is well reasoned and collects the authorities. The factual situation in that case concerned the son of a Chinese merchant who had entered the United States in 1934, while his father had previously entered the United States before July 1, 1924. The case holds that the minor son, upon entry, acquired the domicile of his father

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alien entitled to enter the United States solely to carry on trade between the United States and the foreign state of which he is a national under twenty-one years of age, if accompanying or following to join him. * * *"

and that the domicile was sufficient to permit the naturalization of the son. The reasoning of the case, and the authorities, apply equally to a treaty merchant entering the United States after July 1, 1924.

But it further appears to the court that the language of the articles of the two treaties heretofore set forth in the margin, contain in their very language provisions that the treaty merchant shall have domicile or permanent residence in the United States.

The Treaty of 1880 in Article II, provides that Chinese merchants "shall be accorded all rights, privileges, immunities and exemptions which are accorded to the citizens and subjects of the most favored nation." This certainly would include the right to permanent residence or domicile sufficient for naturalization.

The Treaty of 1884, in Article III, provides that "the provisions of this convention shall not affect the right at present enjoyed of Chinese * * * merchants * * * of coming to the United States and residing therein. The words "residing therein" indicate clearly the intention of the treaty making powers to provide for permanent residence or domicile in the United States on the part of Chinese merchants and the other classes therein enumerated.

The Government cites cases to the effect that the mere fact that an alien is not deportable does not create a status of lawful permanent residence in the United States. [21]

> Subhi Mistafa Sadi v. U.S., (2 Cir.) 48 F. (2d) 1040; Werblow v. U.S., (2 Cir.) 134 F. (2d) 791.

The court has no disagreement with these holdings.

We hold that the petitioner was lawfully admitted to the United States for permanent residence sufficient for naturalization purposes; and in view of the findings by the designated Examiner that the petitioner, upon his application for admission to the United States was in possession of a certificate as a treaty merchant issued under Section 6 of the Chinese Exclusion Act, and that a certificate of arrival qualified to show the character of his admission as a treaty merchant under Section 3(6) of the Immigration Act of 1924 has been filed with his petition, it follows that both grounds of objection by the United States fail.

The motion of the United States is denied and the application of Kwan Shun Yue for naturalization is granted. The findings of fact, conclusions of law and recommendations of the designated Examiner are adopted by this court, except as they are modified by this opinion. Formal order will be prepared by counsel. [22]

Exhibit D

Form N-484-A
U. S. Department of Justice
Immigration and Naturalization Service
(Edition of 5-15-44)

Vol. 14 page 208

Date: January 5th, 1951 List No. 147

This list consists of two sheets.

Sheet No. 2

ORDER OF COURT

In the District Court of the United States

Southern District of California,
Central Division—ss.

Upon consideration of the petitions for naturalization listed on List No. 147, sheets 1 to 2, dated January 5th, 1951, presented in open Court this 5th day of January, A.D. 1951, It Is Hereby Ordered that each of the said petitions be, and hereby is, denied, except those petitions listed below.

Recommendations of Designated Officer Is Disapproved as to the Petitions Listed Below, and each of said petitioners so listed having appeared in person, It Is Hereby Ordered that each of them be, and hereby is, admitted to become a citizen of the United States of America. Prayers for change of name listed below granted, except in petition No. ....

Petition No.: 131990.
Name of Petitioner: Kwan Shun Yue.
Change of Name: Sun Yee Quon.

The Court adopts the findings of fact and the conclusions of law contained in the recommendation of the designated Naturalization Examiner filed herein, except as they are modified by the Opinion of the Court entered herein on December 29, 1950.

It is further ordered that petitions listed below be continued for the reasons stated.

Petition No.: ....

Name of Petitioner: ....

Cause for Continuance: ....

By the Court.

JAMES M. CARTER,
Judge. [23]

Exhibit E

In the United States District Court in and for the Southern District of California, Central Division

No. 131990

In the Matter of

The Petition of KWAN SHUN YUE, to Be Admitted a Citizen of the UNITED STATES OF AMERICA

NOTICE OF APPEAL TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Notice Is Hereby Given that the United States of America, respondent to the petitioner above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the Order of the Court admitting petitioner to citizenship

made on January 5, 1951, and entered on said date in Civil Order Book Volume 14, at page 208.

Dated at Los Angeles, California, this 27th day of February, 1951.

ERNEST A. TOLIN,
United States Attorney.

CLYDE C. DOWNING,
Assistant U. S. Attorney
Chief, Civil Division.

/s/ ROBERT K. GREAN,
Assistant U. S. Attorney.

Attorneys for Respondent and Appellant, United States of America.

[Endorsed]: Filed April 2, 1951. [24]

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

I, Edmund L. Smith, Clerk of the United States District Court for the Southern District of California, do hereby certify that the foregoing pages numbered from 1 to 24, inclusive, contain the original Agreed Statement of Facts on Appeal which constitutes the record on appeal to the United States Court of Appeals for the Ninth Circuit.

Witness my hand and the seal of said District Court this 4th day of April, A.D. 1951.

[Seal] EDMUND L. SMITH,
Clerk,

By /s/ THEODORE HOCKE,
Chief Deputy.

States as an immigrant for permanent residence, was exempt from the necessity of filing such Certificate of Arrival.

Appellant designates the entire record to be printed.

Dated at Los Angeles, California, this 30th day of March, 1951.

ERNEST A. TOLIN,
United States Attorney.

CLYDE C. DOWNING,
Assistant U. S. Attorney,
Chief, Civil Division.

/s/ ROBERT K. GREAN,
Assistant U. S. Attorney,
Attorneys for Appellant.

Affidavit of Service by Mail attached.

[Endorsed]: Filed April 5, 1951.

No. 12891

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

KWAN SHUN YUE,

Appellee.

APPELLANT'S OPENING BRIEF.

ERNEST A. TOLIN,
United States Attorney,
CLYDE C. DOWNING,
Assistant U. S. Attorney,
Chief, Civil Division,
ROBERT K. GREAN,
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600 Federal Building,
Los Angeles 12, California,
Attorneys for Appellant.

Parker & Company, Law Printers, Los Angeles. Phone MA. 6-9171.

TOPICAL INDEX

TABLE OF AUTHORITIES CITED

No. 12891

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

United States of America,

Appellant,

vs.

Kwan Shun Yue,

Appellee.

APPELLANT'S OPENING BRIEF.

I.

Jurisdictional Statement.

(a) The United States District Court for the Southern District of California had jurisdiction by virtue of 8 U. S. C. 701 (Jurisdiction to Naturalize), and the matter came before the Court on the motion of the United States of America for an order denying the petition of Kwan Shun Yue, a national of China, for naturalization.

(b) This Court has jurisdiction by virtue of 28 U. S. C. 1291 (Final Decisions of District Courts).

II.

Statement of Facts.

The petitioner, Kwan Shun Yue, applied for admission to the United States at Seattle, Washington, July 20, 1924, in possession of a certificate, as a treaty merchant, issued under Section 6 of the Chinese Exclusion Act (22 Stat. 58, Act of May 6, 1882, as amended). The certifi-

cate had been visaed by the American Consul at Hong Kong, June 27, 1924, and petitioner sailed from China about July 2, 1924. On September 9, 1924, the Board of Review of the Department of Labor ordered the subject excluded on the ground that he was not coming to the United States as a bona fide merchant under and in pursuance of any treaty of commerce and navigation.

Habeas Corpus proceedings were instituted in behalf of petitioner and others in the District Court for the Western District of Washington, and the writ was granted. The judgment of the District Court was affirmed by the United States Court of Appeals for the Ninth Circuit on November 13, 1925, in the case of *Weedin v. Wong Tat Hing, et al.*, 6 F. 2d 201.

A certificate of arrival, showing petitioner's admission as a treaty merchant under Section 3(6) of the Immigration Act of 1924 was filed with the petition in this proceeding for naturalization [R. 24, 3, 10, 28.]

The United States moved for an order denying the petition for naturalization [R. 3] on the grounds that (a) petitioner has failed to establish lawful admission to the United States for permanent residence and (b) a valid certificate of arrival was not filed with the petition. [R. 23.]

Said motion came on for hearing before the Honorable James M. Carter, Judge of the said District Court, on or about the 29th day of December, 1950. The Court thereupon denied the motion of the United States and ordered petitioner admitted to citizenship. [R. 4, 33.]

III.

Questions Presented by Appeal.

(a) Whether the petitioner's admission to the United States after July 1, 1924, as a treaty merchant, was admission to the United States for permanent residence for naturalization purposes.

(b) Whether a certificate of arrival as a treaty merchant satisfies the requirement that a certificate of arrival showing lawful entry as an immigrant for permanent residence must be filed with petitioner's petition for naturalization.

IV.

ARGUMENT.

A. Petitioner's Admission to the United States After July 1, 1924, as a Treaty Merchant Was Not for Permanent Residence for Naturalization Purposes.

The issue in the instant case should not be confused with recent decisions holding that Chinese persons who have been admitted to the United States *subsequent* to July 1, 1924, as minor children of Chinese merchants who had been admitted to the United States *prior* to July 1, 1924, could be considered as having a lawful admission for permanent residence for naturalization purposes (*Wong Choon Hoi,* 71 Fed. Supp. 160, appeal dismissed 164 F. 2d 699, 9 Cir. 1947; *Petition of Chi Yan Cham Louie,* 70 Fed. Supp. 493, app. dism. 166 F. 2d 15, 9 Cir. 1947; *Pet'n of David Jow Gin,* U. S. D. Ct., Chicago, No. 323406, app. dism., 7 Cir. 6/9/49, 175 F. 2d 299; and *Petition of Yung Poy,* 177 F. 2d 144.) In those cases the fathers had been admitted *prior* to July 1, 1924, and were considered as having a lawful admission for perma-

nent residence, while the minor children were considered to have gained their permanent residence through the theory of domicile of the parent.

In the instant case, he was admitted on his *own* status as a merchant and not on the basis of any rights derived from a person who had previously been admitted for permanent residence.

This petitioner's right to enter the United States was predicated essentially upon Article II of the Treaty of Commerce and Navigation with China, dated November 17, 1880[1] (22 Stat. 8261), and a subsequent treaty of March, 1894[2] (28 Stat. 1210).

Since, however, the instant petitioner entered the United States after July 1, 1924, his status must also be evaluated in the light of the Immigration Act of 1924, 43 Stat. 153, which became effective on July 1, 1924. It is not disputed that Chinese merchants and their families who entered the United States prior to July 1, 1924, may be regarded as

---

[1]The pertinent section of Article II of the Treaty reads as follows: "Chinese subjects, whether proceeding to the United States as teachers, students, merchants or from curiosity, together with their body and household servants, and Chinese laborers who are now in the United States, shall be allowed to go and come of their own free will and accord, and shall be accorded all the rights, privileges, immunities and exemptions which are accorded to the citizens and subjects of the most favored nation."

[2]The pertinent section of the Treaty is Article III, which reads as follows: "The provisions of this convention shall not affect the right at present enjoyed of Chinese subjects, being officials, teachers, students, merchants or travellers for curiosity or pleasure, but not laborers, of coming to the United States and residing therein. To entitle such Chinese subjects as are above described to admission into the United States, they may produce a certificate from their government or the government where they last resided visaed by the diplomatic or consular representative of the United States in the country or port whence they depart * * *"

admitted for permanent residence, as neither the Treaty nor the Act of May 6, 1882, as amended by the Act of July 5, 1884, then in effect, contained any limitation restricting the term or nature of their stay in the United States. However, in enacting the Immigration Act of 1924, Congress made drastic revisions in the earlier patterns of regulation. All aliens seeking to enter the United States were designated as immigrants, except the groups classified as non-immigrants in Section 3, 8 U. S. C. 203. Immigrants were required to obtain immigration visas, and, except for those classified as non-quota immigrants, were subject to quota restrictions. (Secs. 4, 11, 13(a), Immigration Act of 1924, 8 U. S. C. 204, 211, 213(a).) Section 3(6) of the 1924 Act, 8 U. S. C. 203(6), classified as a non-immigrant "an alien entitled to enter the United States solely to carry on trade under and in pursuance of the provisions of a present existing treaty of commerce and navigation."

Judge Carter stated, with respect to the Treaties of November 17, 1880 and March 17, 1894, between this country and China, and the Immigration Act of 1924, that "It is elemental that Congress, by statute, cannot vary or diminish rights created by a Treaty, * * *" [R. 30.] We challenge this statement by the Court and would cite to the contrary so recent an authority as the decision of the Supreme Court in the case of *Moser v. United States,* 71 S. Ct. 553, wherein a treaty with Switzerland and the Selective Training and Service Act were considered. In that case, the Supreme Court said "Not doubting that a treaty may be modified by a subsequent Act of Congress, it is not necessary to invoke such authority here, * * *" In support of the statement that a treaty may be modified by a subsequent Act of

Congress, the Supreme Court cited the following cases: *Clark v. Allen,* 331 U. S. 503; *Pigeon River Improvement, Slide & Boom Co. v. Charles W. Cox, Ltd.,* 291 U. S. 138; *Head Money Cases* (*Edye v. Robertson*), 112 U. S. 580.

However, in enacting Section 3(6) of the 1924 Act, Congress did not seek to nullify existing treaties. On the contrary, the legislative history indicates that Section 3(6) was designated to safeguard treaty obligations. (House Rep. 360, 68th Cong., 1st Sess.) But in limiting the terms of admission, Congress actually was effectuating the purpose of the treaties, which sought merely to enable nationals of the contracting nations to enter for the purposes of trade, and not for permanent settlement. This aim seems clearly shown in the 1880 treaty with China, which lists merchants with traders, students and travelers for curiosity—clearly not permanent settlers—and authorized the excepted categories "to go and come of their own free will and accord." This hardly appears to have envisioned a formula for permanent settlement. As pointed out by the House Committee on Immigration and Naturalization in House Report 360, 68th Congress, 1st Session, page 2, with respect to the bill which became the Immigration Act of 1924, the admission of non-immigrants for a limited time only and so long only as they maintain the status under which admitted "fully satisfies treaty requirements." Congress in the 1924 Act, therefore, deliberately excluded the treaty merchants from its designation as immigrants—those coming for permanent residence—and listed them with the non-immigrants—whose sojourn was limited in period or purpose. It can hardly be disputed, therefore, that treaty merchants, including those who entered under the treaty with China, admitted

to the United States after June 30, 1924, are not classed as permanent residents for naturalization purposes, nor do the treaties with China, pertinent sections of which are set out as footnotes, *supra,* contain any obligation to admit merchants for permanent residence.

In consequence, Section 3(6) merchants have, by regulations of the Immigration and Naturalization Service ever since the effective date of the Immigration Act of 1924 been admitted only temporarily, to continue during maintenance of status as a merchant. Such regulation has been known to Congress and received its implied approval. One indication of this is the Committee Reports (Senate Report No. 805, 72nd Congress, 1st Session; and House Report No. 431, 72nd Congress, 1st Session) upon the Act of July 6, 1932 (47 Stat. 607), amending Section 3(6) of the Immigration Act of 1924 wherein the Committees of the Senate and the House in separate reports but in identical language stated as follows:

> "Under the present law one of the classes of aliens stated in section 3 of the immigration act of 1924 to be excepted from aliens who are defined in the section to be 'immigrants' is '(6) an alien entitled to enter the United States solely to carry on trade under and in pursuance of the provisions of a present existing treaty of commerce and navigation.' Under the regulations issued by authority of section 24 of the act to carry out the provisions of the act, the provisions of section 3(6) have been interpreted to accord nonimmigrant status to an alien coming to the United States solely to carry on trade of an international character between the United States and the foreign state from which he comes under and in pursuance of the provisions of a treaty of commerce and navigation in existence at the time of the

> passage of the immigration act of 1924. The provisions of the section referred to have also been interpreted to be applicable to the wives and minor children of treaty aliens in line with the holding of the Supreme Court of the United States in Cheung Sum Shee v. Nagle (268 U. S. 336)."

The regulation of the Immigration and Naturalization Service in effect at that time, which is mentioned in the foregoing, provided as follows (Rule 3, subd. H, par. 3):

> "Where the examining officer is satisfied beyond a doubt that an alien seeking to enter the United States as a non-immigrant pursuant to subdivision (6) of section 3 of the immigration act of 1924 is entitled to enter solely to carry on trade under and in pursuance of a treaty of commerce and navigation which existed on May 26, 1924, he may admit such alien, or his lawful wife and minor children, if otherwise admissible, on condition that such alien shall maintain such status of a non-immigrant during his stay in the United States, and upon failure or refusal to maintain such status that he will voluntarily depart."

This case, therefore, falls squarely within the reasoning of *In re Pezzi,* 29 F. 2d 999, D. C., Calif. (1928). That case was a petition for naturalization by a woman who had entered the United States in 1925 as a non-immigrant alien. In 1926 she was granted permission by the Department of Labor to remain in the United States indefinitely, so long as her husband maintained his status as a treaty merchant. The record showed that the petitioner was admitted to the United States under Section 3(2) of the Immigration Act of 1924 and that her status was later changed to that of the wife of a treaty merchant under Section 3(6) of that act. The petitioner had re-

sided in the United States for the statutory period and urged that she intended to remain permanently in the United States; that, consequently, she was lawfully admitted to the United States for permanent residence and was therefore eligible for naturalization. The Court denied the petition, and held, at page 1001:

> "In order to be entitled to naturalization, an alien must establish lawful entry into the United States as an immigrant, with intent to remain in the United States permanently. An alien who enters the United States *without inspection and admission as an immigrant for permanent residence* is not entitled to naturalization under our statutes. *Kaplan v. Tod,* 267 U. S. 228, 45 S. Ct. 257, 69 L. Ed. 585; *In re Kempson, et al.,* 14 F. 2d 668; *In re Jensen,* 11 F. 2d 414; *Ex Parte Marchant, et al.,* 3 F. 2d 695."

The Court further said, at page 1002:

> "Has the petitioner here met the requirements of the law? I think not. The petitioner has no status in the United States, other than being the wife of her husband. Her husband's status is defined by the provisions of Section 3 of the Quota Act of 1924 and the treaty of commerce and navigation between the United States and Italy of 1871 (17 Stat. 845). This treaty defines the status of 'Italian citizens in the United States and citizens of the United States in Italy.' Article 1. It clearly contemplates the temporary stay of the merchants of one country in the territory of the other. It accentuates the fact that the citizen of the one country is entitled to certain rights and privileges in the other country, including the privilege of being accompanied by wife, minor children, servants, etc., solely and wholly because such citizen of one country is in the other

country, temporarily, and for no other purpose than to carry on trade. There is not the slightest thought involved in the language of the treaty that the citizen of one country, residing in the other country as a treaty merchant, is laying the foundation for becoming a citizen of the other. Everything in the treaty negatives that thought.

Neither the petitioner nor her husband could have been admitted, under the credentials they carried, as immigrants or as persons coming for the purpose of permanently residing in the United States. They were admitted specifically as nonimmigrant aliens, and specifically under the language of the Quota Law of 1924, as 'aliens entitled to enter * * * solely to carry on trade under and in pursuance of the provisions of a present existing treaty of commerce and navigation.' 8 U. S. C. 203. The word 'solely' there means exactly what it says."

The Court referred to the argument of counsel as to the petitioner's rights under the treaty with Italy, and said:

"The treaty rights are clear and unambiguous, and are limited solely to the right of all the freedom of movement and protection under our laws that are essential to the carrying on of trade as a citizen of a friendly nation, really moving in this country under the flag of his own country and being here for temporary purposes. The Immigration Quota Act of 1924 sharpens this doctrine of the rights of a treaty merchant and is wholly in harmony with it. Should it be true that the Immigration Act contains additional limitations, that makes the status of the treaty merchants all the more pronounced."

The Court consequently ruled that the petitioner had not complied with the requirements of the naturalization laws as to an entry into the United States for permanent residence, and that therefore her petition must be denied. It should be noted that the treaty that was under consideration in the *Pezzi* case, the treaty with Italy of February 26, 1871, specifically provided that the citizens of the respective countries parties to the treaty would have the "liberty to sojourn and reside in all parts whatever of said territories," referring to the territories of the countries. They were also given the right to enjoy the privileges and rights of natives of the countries and to carry on trade and commerce with restriction (17 Stat. 845.) Likewise, under Article II of the treaty, citizens of each of the countries had the right to travel in the states and territories of the other country.

The similarity between the foregoing case and the present issue cannot lightly be disregarded. In both cases the petitioners were admitted to the United States subsequent to the passage of the Immigration Act of 1924; in both cases the status of the petitioners was that of a nonimmigrant under Section 3(6) of that Act, with the right to remain indefinitely in the United States; in both cases the immigration status of the petitioners was based upon a treaty with a foreign country relating to trade and commerce. No good reason, in fact or law, can be discerned why the rule in the case of *In re Pezzi* should not apply to the present issue, particularly since the cited case is not unique but represents a theory of law which has been uniformly followed.

In the case of *Subhi Mustafa Sadi v. United States,* 48 F. 2d 1040 (2 Cir. 1931), a petition for naturalization was

filed by a person who had entered the United States on August 1, 1923, as a non-quota immigrant, student, under the Immigration Act of 1921. Deportation proceedings were instituted against him and upon application for habeas corpus such proceedings were dismissed on the ground that he was exempt from the quota and not subject to deportation. In connection with his petition for naturalization, the subject argued that the order sustaining the writ of habeas corpus fixed his status as an alien admitted to the United States for permanent residence. The Court denied the petition for naturalization, and stated:

> "This appears to be a case of unusual hardship, but the status above quoted explicitly forecloses any right to the appellant to be admitted to citizenship on his pending petition. We do not now undertake to determine whether or not he was entitled to entry for permanent residence at the time he was admitted at Boston. The fact remains that he was not so admitted, and while that record stands he cannot comply with the statute requiring his lawful entry for permanent residence to be established. See *In re* Weig, 30 F. 2d 418.
>
> It is urged that the order sustaining the writ of habeas corpus fixed his status as that of an alien admitted for permanent residence. To the extent that it had the effect of preventing his deportation upon the warrant which had been issued, it did, of course, lend some color of permanence to his stay, in that he successfully withstood that attempt to deport him, but it did not change in any respect the terms and conditions of his original entry. It simply gave effect to the right he then possessed to remain in this country notwithstanding the order

of deportation which had been issued. In respect to his ability to lay an essential foundation for his admission to citizenship, he stands in exactly the same situation he would have been had no warrant for his deportation been issued and no writ of habeas corpus sustained in his behalf."

Upon rehearing the Court again said, at page 1041:

> "To be sure, his discharge on the writ of habeas corpus did, as we said before, establish his right to remain in this country in spite of the effort then being made to deport him, but, because it did not necessarily require proof that he had been admitted for permanent residence, it now is of no aid to him when he must show that fact as a condition precedent to the validity of his petition for naturalization. See U. S. *ex rel.* Gentile v. Day, 25 F. 2d 717."

Here again we see a decision by an appellate court to the effect that the mere fact that a petitioner for naturalization is not deportable, does not create a lawful admission for permanent residence for naturalization purposes. A similar decision was made in *Warblow v. U. S.,* 134 F. 2d 791, (2 Cir. 1943), where the Court in ruling upon the question of lawful continuous residence required of a petitioner for naturalization, said, at page 792:

> "If what is a legal admission for permanent residence for the purposes of naturalization is to be determined in accordance with the immigration laws, it is clear that the appellant had not resided in this country for at least two years immediately preceding the date of his petition in pursuance of a legal admission for permanent residence."

The Court further said:

> "When aliens enter the United States they are lawfully here for permanent residence only if they have complied with the requirements of the laws of this country applicable to the incoming of such people. Those laws are the immigration laws and so far as we know, or the appellant has been able to point out, are the only laws under which the right, or the contrary, of an alien to come here and stay may be determined. When the nature of his residence in the United States has been so determined, his status under the naturalization laws is established so far as that feature is concerned. They set up no different general standards of their own in that regard."

It can be seen, therefore, that insofar as the decisions of the courts are concerned, it is the established rule that a petitioner for naturalization must establish a lawful admission to the United States for permanent residence as an immigrant. The mere fact that the alien is not deportable does not create a status of lawful permanent residence in the United States, nor does a lawful admission as a non-immigrant constitute a basis for a petition for naturalization.

On December 17, 1943, Congress passed the Chinese Exclusion Repeal Act (57 Stat. 600). Section 3 of the Statute directed that Chinese persons or persons of Chinese descent be added to the racial groups that are eligible for naturalization. In enacting this legislation, Congress did not contemplate that all Chinese persons in the United

States should thereby be naturalized. On the contrary, Congress merely put the Chinese on a parity with other racial groups and insisted that they qualify for naturalization on the same terms as all other applicants. This design was specifically asserted by the Congressional Committees which considered the legislation, in the following language (House Rep. 732; Sen. Rep. 535, 78th Congr., 1st Sess.):

> "The number of Chinese who will actually be made eligible for naturalization under this section is negligible. There are approximately 45,000 alien Chinese persons in the United States (continental, territorial, and insular). However, a large number of these Chinese have never been admitted to the United States for lawful permanent residence, which is a condition precedent to naturalization and, therefore, many of this number could not be eligible for naturalization, not because of racial disability, but because they cannot meet existing statutory requirements of the law. The number of Chinese who will be made eligible in the future, in addition to those already here, will of necessity be very small because the quota for China is limited to 105 per annum, as provided for in Section 2 of this bill."

It is concluded that Congress contemplated granting the privilege of naturalization only to those Chinese aliens who were lawfully admitted to the United States for permanent residence as immigrants. As this petitioner was admitted as a non-immigrant, he is not considered as having been lawfully admitted to the United States for permanent residence for naturalization purposes, and the certificate of arrival which forms the basis of his petition for naturalization is not a valid certificate of arrival for naturalization purposes.

B. Petitioner Did Not File With His Petition a Certificate of Arrival Showing Admission to the United States as an Immigrant for Permanent Residence.

Section 329 of the Nationality Act of 1924, 8 U. S. C. 729, provides that

> "No declaration of intention shall be made by any person who arrived in the United States after June 29, 1906, until such person's lawful entry for permanent residence shall have been established, and a certificate showing the day, place, and manner of arrival in the United States shall have been issued."

This provision does not apply, as the appellee by reason of marriage to an American citizen, is applying for naturalization under Section 310 of the Nationality Act of 1940, 8 U. S. C. 710, which does not require declaration of intention, but does require that the petitioner "shall have resided continuously in the United States for at least three years immediately preceding the filing of the petition." And Section 332 of that Act, 8 U. S. C. 732, requires that there be filed with a petition a certificate from the Immigration and Naturalization Service showing "the date, place, and manner of petitioner's arrival in the United States."

Referring again to the case of *Subhi Mustafa Sadi v. United States, supra,* the Court states, at page 1041, in referring to the fact that the record was admitted as a bona fide student for a period of two years:

> "It did not show that he was admitted for permanent residence, and, with the records * * * as

they now stand he cannot prove that he was," and "he could not be admitted to citizenship on his pending petition, since he could not show that he had in fact been admitted for permanent residence as the statute requires."

The above language is cited by the Court in *Jow Gin v. United States* (7 Cir. 1949), 175 F. 2d 299. And the Court goes on to say, at page 304:

> "That a Certificate of Arrival predicated upon a registry made at the time of an alien's entrance into this country showing lawful entrance for permanent residence is an indispensable requisite for admission to citizenship is plainly shown by the authorities. United States v. Ness, 245 U. S. 319, 324, 38 S. Ct. 118, 62 L. Ed. 321; Kaplan v. Tod, 267 U. S. 228, 230, 45 S. Ct. 257, 69 L. Ed. 585; Zartarian v. Billings, 204 U. S. 170, 175, 27 S. Ct. 182, 51 L. Ed. 428. * * *"

The Court further states, on page 305, that the *Pezzi* and *Sadi* cases, *supra,*

> "* * * accentuate the point that an alien is not eligible for naturalization without a Certificate of Arrival showing lawful entry for *permanent residence*." (Emphasis added.)

V.
Conclusion.

The appellee was erroneously naturalized because he had not been lawfully admitted for permanent residence. He had not been so admitted because he was admitted under Section 3(6) of the Immigration Act of 1924, which kind of admission was as a non-immigrant for a temporary period, subject to be terminated upon abandonment or termination of status under which admitted. Such condition of temporary admission necessarily follows from the application of Sections 3(6), 15, 25 and 28 of the Immigration Act of 1924 (8 U. S. C. 203, 215, 223 and 224).

If the decision in the instant case stands, it applies to aliens coming as traders under any of nearly 30 treaties with foreign countries listed on pages 41, 42, Immigration Laws and Regulations, Ed. of March 1, 1944, that are considered treaties of Commerce and Navigation within Section 3(6) of the Immigration Act of 1924. If aliens admitted as traders under these treaties or their wives and minor children are entitled to naturalization after the required periods of residence here after admission, the result would be an endless chain of aliens obtaining admission and naturalization through Section 3(6) for the reason that as soon as they obtain naturalization they can move into lines of trade not within the terms of that provision and thus leave the international business for other aliens to come here and engage in under those treaties and that provision, one set after another, in the face of the fact

that Section 3(6) describes a class of aliens who are not immigrants and not subject to the stricter documentary requirements of the Immigration Act of 1924 as to immigration visas and quota restriction upon the issuance of such visas. A construction of the single provision of Section 3(6) that leads to such a defeat of the purposes of the restrictive provisions of the whole Immigration Act of 1924 is absurd, and the well-settled rule of law is "that statutes should receive a sensible construction, such as will effectuate the legislative intention, and, if possible, so as to avoid an unjust or absurd conclusion."

Lau Ow Bew v. United States, 144 U. S. 47, 59.

Respectfully submitted,

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No. 12891

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

United States of America,

Appellant,

vs.

Kwan Shun Yue,

Appellee.

APPELLEE'S BRIEF.

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No. 12891

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UNITED STATES OF AMERICA,

Appellant,

vs.

KWAN SHUN YUE,

Appellee.

APPELLEE'S BRIEF.

Jurisdiction.

Kwan Shun Yue filed his petition for naturalization in the United States District Court for the Southern District of California pursuant to provisions of 8 U. S. C. 701 (Jurisdiction to Naturalize) and the petitioner was admitted to citizenship.

This appeal is from the final order of admission entered by the trial court.

Statement of Facts.

The facts are not in dispute. An agreed statement appears in the transcript of record, page 1, and the statement as set forth in Appellant's Opening Brief is accepted.

Questions Presented on Appeal.

1. Whether the petitioner's residence in the United States since November 13, 1925, has been permanent and constitutes residence entitling him to be naturalized as a citizen of the United States.

2. Whether the certificate of arrival filed with his petition is legally sufficient.

ARGUMENT.

A. Petitioner's Admission to the United States on November 13, 1925, as a Treaty Merchant Entitled Him to Permanent Residence for Naturalization Purposes.

The Appellee is of Chinese race and applied for admission to the United States at Seattle, Washington, July 20, 1924, in possession of a certificate, as a treaty merchant, issued under provision of Sec. 6 of the Chinese Exclusion Act (22 Stat. 58, Act of May 6, 1882, as amended). His application to enter, together with similar applications of twelve others, was denied by the Department of Labor upon the grounds that the applicant was not a merchant within the meaning of the Immigration Act of July 1, 1924. A Writ of Habeas Corpus was granted by the trial court allowing the petitioners to land and the same was sustained on appeal. (*Weedin v. Wong Tat Hing, et al.,* 6 F. 2d 201.)

The question involved in *Weedin v. Wong Tat Hing, supra,* was whether or not the Immigration Act of July 1, 1924, had superseded or abrogated the treaty between the United States and China (22 Stat. 826) and the Chinese Exclusion Acts of 1882 and 1884 which were

passed for the expressed purpose of executing the stipulations of that treaty. The court said, at page 202:

> "The appellees, who are merchants, were clearly admissible under the Act of 1884, and they are still admissible, unless excluded by some provision of the Act of 1924."

The court then pointed out that the Act of 1924 did not supersede or abrogate either the treaty or the Chinese Exclusion Acts but that Chinese, including the subject of this appeal, were entitled to admission to the United States under provision of the treaty and the Acts of 1882 and 1884 and not under provision of the Act of 1924. At the bottom of page 202 the court states:

> "For these reasons, we are of opinion that Chinese merchants are still entitled to be admitted to the United States; that the certificates prescribed by section 6 of the Act of 1884 are still the sole evidence permissible on their part to establish their right of entry into the United States; and, that the certificates, when produced, are still *prima facie* evidence of the facts therein stated."

Prior to December 17, 1943, immigration and travel of Chinese to the United States was not governed by the United States Immigration Laws pertaining to aliens generally, but by the so called Burlingame Treaties. (22 Stats. 826, 1880 and 28 Stats. 1210, 1894, and the Chinese Exclusion Act 22 Stats. 58 etc.) The pertinent section of the treaty of 1880 reads as follows:

> "Chinese subjects, whether proceeding to the United States as teachers, students, merchants or from curiosity, together with their body and household servants, and Chinese laborers who are now in

> the United States shall be allowed to go and come of their own free will and accord, and shall be accorded all the rights, privileges, immunities and exemptions which are accorded to the citizens and subjects of the most favored nation."

The pertinent section of the treaty of 1884 reads as follows:

> "The provisions of this convention shall not affect the right at present enjoyed of Chinese subjects, being officials, teachers, students, merchants or travellers for curiosity or pleasure, but not laborers, of coming to the United States and residing therein. To entitled such Chinese subjects as are above described to admission into the United States, they may produce a certificate from their Government or the government where they last resided fixed by the diplomatic or consular representative of the United States in the country or port whence they depart . . ."

The Chinese Exclusion Act (22 Stats. 58 etc., Act of May 6, 1882, as amended) provided for execution of the treaties and the evidence required to permit the Chinese alien to enter the United States as a merchant and to reside here. Kwan Shun Yue, appellee herein, entered the United States in conformity with the provisions of these laws on November 13, 1925, as dictated by court order (*Weedin v. Wong Tat Hing, et al.,* 6 F. 2d 201) and has resided permanently in the United States since said date.

Chinese merchants, who lawfully entered the United States as such, under provisions of the applicable laws, were not required to maintain their status as merchants in order to remain here for permanent residence. (*Lo Hop*

v. U. S., 257 Fed. 489, 168 C. C. A. 493; *Chung Yim v. U. S.,* 78 F. 2d 43, cert. den. 1935, 56 S. Ct. 150, 296 U. S. 627.)

Alien Chinese were ineligible to citizenship in the United States until December 17, 1943.

Section 13(c), Immigration Act of 1924 (43 Stat. 153, 8 U. S. C. 201), provided as follows:

> "No alien ineligible to citizenship shall be admitted to the United States unless such alien . . . (3) is not an immigrant as defined by Sec. 3, . . ."

Section 3 of said Act as it stood November 13, 1925, read as follows:

> "When used in this Act the term 'immigrant' means any alien departing from any place outside the United States destined for the United States, except, . . . (6) an alien entitiled to enter the United States solely to carry on trade under and in pursuance of the provisions of a treaty of commerce and navigation, . . ."

Section 15 of said Act provides as follows:

> "The admission to the United States of an alien excepted from the class of immigrants by clause . . . (6) of Sec. 3, . . . shall be for such time and under such conditions as may be by regulations prescribed (including when deemed necessary . . ., the giving of bond with sufficient surety, in such sum and containing such conditions as may be by regulations prescribed) to insure that, at the expiration of such time or upon failure to maintain the status under which admitted, he will depart from the United States: . . ."

These are the provisions of the Act of July 1, 1924, under which the Department of Labor attempted to bar entry of the appellee when he applied for admission to the United States on July 20, 1924, and which the courts then held did not apply to him but that he was admissible for permanent residence under terms of the treaty and the Chinese Exclusion Act as hereinafter pointed out.

It is submitted that the exact question now raised by appellant was raised and settled between the same parties in *Weedin v. Wong Tat Hing, et al.,* 6 F. 2d 201, and is now *res adjudicata.*

Cheung Sum Shee v. Nagle, 268 U. S. 336, further settles the point. This case went to the United States Supreme Court on a question certified out of the *Wong Tat Hing* case as to whether or not the Immigration Act of 1924 abrogated the Treaty of 1880 so as to make the wives and minor children of Chinese merchants inadmissible to the United States. The court held that the Act of May 26, 1924, did not abrogate the Treaty. At page 345 the opinion states:

> "The wives and minor children of resident Chinese merchants were guaranteed the right of entry by the Treaty of 1880 and certainly possessed it prior to July 1, 1924, when the present Immigration Act became effective. (*U. S. v. Mrs. Gue Lim,* 176 U. S. 459.) That Act must be construed with the view to preserve Treaty rights unless clearly annulled, and we cannot conclude that, considering its history, the general terms therein disclose a congressional intent absolutely to exclude the petitioner from entry.
>
> "In a certain sense it is true that petitioners did not come 'solely to carry on trade.' But Mrs. Gue Lim did not come as a 'merchant'. She was never-

> theless allowed to enter upon the theory that a treaty provision admitting merchants by necessary implication extended to their wives and minor children. The rule was not unkown to Congress when considering the Act now before us, nor do we think the language of Sec. 5 is sufficient to defeat the rights which petitioner has under the treaty. In a very definite sense, they are specified by the Act itself as 'non-immigrant.' They are aliens entitled to enter in pursuance of a treaty as interpreted and applied by the Court 25 years ago."

The foregoing decision is applied to consideration of Section 5 of the Immigration Act of 1924. The Government in the instant case contends that petitioner was admitted under Section 3 of the same Act. It must be noted that Section 13(c) of the same Act specifically prohibits the admission of petitioner as an "alien ineligible to citizenship" and the only law available to him at the time of his entry was the Treaty of 1880. The reasoning advanced by the Supreme Court in *Cheung Sum Shee v. Nagle* (268 U. S. 336), applies equally to Section 3 of the Immigration Act of 1924. The Act did not modify or abrogate the treaty in any respect and the petitioner was lawfully admitted under the terms of said treaty for permanent residence in the United States.

The treaty between the United States and China (22 Stat. 826) and the Acts of 1882 and 1884 constituted the sole and exclusive laws under provisions of which Chinese nationals were admissible to the United States until the Chinese Exclusion Acts were repealed on December 17, 1943 (57 Stat. 600). The effect of the Act of December 17, 1943, was to make persons of the Chinese race eligible to immigrate to and become citizens of the

United States by naturalization and for the first time made them subject to the Immigration and Naturalization Laws of the United States including the Immigration Act of July 1, 1924.

The cases uniformly hold that Chinese merchants admitted to the United States prior to July 1, 1924, under the provisions of the self-same treaty and acts as governed the entry of the present subject were admitted for permanent residence and are considered as having a lawful admission for permanent residence for naturalization purposes and that the children admitted after July 1, 1924, of fathers admitted prior to July 1, 1924, also are considered as having a lawful admission for permanent residence for naturalization purposes. Counsel finds no court decisions in the case of Chinese merchants arriving after July 1, 1924, except the instant case as reported in *Weedin v. Wong Tat Hing, supra.*

Other cases holding to the same effect are:

> *Haff v. Yung Poy,* 68 F. 2d 203 (C. C. A. 9);
> *Ex parte Goon Dip,* 1 F. 2d 811 (Judge Neterer);
> *Wong Sun Fay v. U. S.,* 13 F. 2d 67 (C. C. A. 9);
> *Ex parte Chi Yan Cham Louie,* 70 Fed. Supp. 493;
> *Ex parte Wong Choon Hoi,* 71 Fed. Supp. 160.

Appellant admits the sufficiency of the entry and the permanency of residence of Chinese merchants admitted prior to July 1, 1924, and to their children admitted after July 1, 1924, but denies the same status to the present subject Kwan Shun Yue who applied for admission to the United States on July 20, 1924, and was actually admitted on November 13, 1925, under the provisions of the self-same treaty and acts, after the Circuit Court of Ap-

peals, Ninth Circuit, and the United States Supreme Court established his right to enter under provision of the said treaty and acts and specifically held that the Act of July 1, 1924, did not supersede or abrogate the treaties and acts pertaining to Chinese.

> *Weedin v. Wong Tat Hing, et al.,* 6 F. 2d 201;
> *Cheung Sum Shee v. Nagle,* 268 U. S. 336.

Even though the Court of Appeals and the United States Supreme Court specifically said the Act of July 1, 1924, did not supersede or abrogate the treaty and laws pertaining to Chinese and ordered the subject admitted in compliance with the prior existing treaty and acts pertaining to Chinese and held the rights of Chinese applying under provision of said laws to be unaffected by the Act of July 1, 1924, appellant still contends that the right of the subject Kwan Shun Yue to establish a permanent residence in the United States is governed by the Act of July 1, 1924. The contention does not make sense. The right of a Chinese on November 13, 1925, to admission and residence in the United States is measured by the same law as existed immediately prior to July 1, 1924. Kwan Shun Yue established lawful residence in the United States November 13, 1925, when the courts held he was eligible for admission to the United States for permanent residence. He has resided permanently here since said date and has met the residence requirement for naturalization purposes.

Appellant relies on the case *In re Pezzi,* 29 F. 2d 999, but points out that she "had entered the United States in 1925 as a non-immigrant alien. In 1926 she was granted permission by the Department of Labor to remain

in the United States indefinitely, *so long as her husband maintained his status as a treaty merchant.*" (Italics ours.) (Op. Br. p. 8.)

The status of Pezzi in the United States was conditional from the beginning and she never had any basis for permanency. Not so with the appellee herein. He was lawfully admitted under the provisions of the treaty and acts passed pursuant thereto as a merchant, for permanent residence, and with no provision or requirement to maintain his status or to ever depart from the United States.

The cases cited in support of the *Pezzi* case all involve persons who either entered the United States illegally or who remained in the United States beyond a specified time for which they were lawfully admitted. None of these facts exist in the instant case.

B. The Certificate of Arrival Filed With the Petition for Naturalization Is Legally Sufficient.

The law pertaining to the filing of a petition for naturalization reads in part as follows (8 U. S. C. 732(c)):

> "At the time of filing the petition for naturalization there shall be filed with the clerk of court a certificate from the Service, if the petitioner arrived in the United States after June 29, 1906, stating the date, place, and manner of petitioner's arrival in the United States, . . . which certificate . . . shall be attached to and made a part of said petition."

The prescribed certificate of arrival in this case was provided by the Immigration and Naturalization Service and attached to and made part of appellee's petition for naturalization [Tr. 24]. Notwithstanding the decision of

the Circuit Court of Appeals (*Weedin v. Wong Tat Hing,* 6 F. 2d 201), and of the United States Supreme Court (*Cheung Sum Shee v. Nagle,* 268 U. S. 336) the Service seems to have insisted on entering a statement on said certificate that the alien "was lawfully admitted to the United States of America under Section 3(6) of the Immigration Act of 1924." However, this notation is mere surplusage since it is mere surplusage since it is not required under the law and the certificate does meet the full requirements in the following particulars:

"Name: Kwan Shun Yue.

Port of Entry: Seattle, Washington.

Date: November 13, 1925.

Manner of Arrival: SS President Grant." [Tr. 24].

Conclusion.

The appellee met all the requirements of the naturalization laws. He was lawfully admitted under terms of the treaty and in compliance with provisions of the Chinese Exclusion Act and such entry under court interpretation was for permanent residence so as to entitle appellee to naturalize under the act of December 17, 1943, relating to persons of the Chinese race.

The consternation of appellant relative to opening the gate to nationals of thirty (30) foreign countries who may enter as treaty merchants is unfounded since the treaties between the United States and China and the statutes effectuating said treaties together with the Chinese Exclusion Act were all peculiar to and applied only to Chinese. The primary purpose of these laws was to exclude Chinese coolie labor. They permitted entry and

residence in the United States of "merchants." Under these laws Chinese merchants were not required to carry on international as distinguished from local trade. Once admitted they were permitted to reside permanently in the United States and to bring their families for permanent residence with them. To the knowledge of Counsel no such provisions of law existed in any other trade treaties to which the United States was or is a party. This problem is peculiar to Chinese only. These laws pertaining to Chinese were repealed December 17, 1943, and the question can only affect a very small number of Chinese persons who entered the United States under provisions of said laws prior to December 17, 1943.

The certificate of arrival filed with the petition contains all the data required by law and is legally sufficient.

Judgment of the trial court should be sustained.

Respectfully submitted,

Benjamin W. Henderson,
Attorney in behalf of Appellee.

No. 12894

United States Court of Appeals for the Ninth Circuit.

UNITED STATES OF AMERICA,

Appellant,

vs.

PACIFIC ABSTRACT TITLE CO., a Corporation,

Appellee.

Transcript of Record

Appeal from the United States District Court, for the District of Oregon.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF ATTORNEYS OF RECORD

HENRY L. HESS,

United States Attorney;

VICTOR E. HARR,

Assistant United States Attorney;

United States Courthouse,
Portland, Oregon;

THOMAS R. WINTER,

Special Assistant to Attorney General, Seattle;

Attorneys for Appellant.

WILL H. MASTERS,

Yeon Building, Portland, Oregon,

Attorney for Appellee.

In the District Court of the United States for the District of Oregon

Civil Action No. 5290

PACIFIC ABSTRACT TITLE CO., a Corporation,

Plaintiff,

vs.

THE UNITED STATES,

Defendant.

COMPLAINT

Plaintiff, for cause of action against the abovenamed defendant, complains and alleges as follows:

I.

That plaintiff is a citizen of the United States residing at Portland, Oregon. That this action is brought in this Court under the jurisdiction and by virtue of Title 28 U.S.C.A., Section 1340 and Section 1346 to recover money erroneously and illegally assessed or collected. That the Collector of Internal Revenue for the District of Oregon, who collected said tax, is not in office at the time of the filing of this action.

II.

That during all times hereinafter set forth, J. W. Maloney was the duly appointed, qualified and acting Collector of Internal Revenue for the District of Oregon and the person who collected the erroneous and illegally assessed tax, but that said J. W. Maloney is no longer in office as Collector of In-

ternal Revenue for the District of Oregon.

III.

That plaintiff was required to and did under oath, file its income tax return on or before the 15th day of March, 1946, for the calendar year 1945 with the Collector of Internal Revenue at Portland, Oregon. That such return was filed presumably by the Commissioner of Internal Revenue on Form 1120 and 1121.

IV.

That such return was filed on an accrual basis which specifically stated the items of plaintiff's gross income and the deductions and credits allowed by the Internal Revenue Code. That plaintiff paid the amount of the tax showing to be owing to the United States on said return as required to said Collector of Internal Revenue for the District of Oregon in installments as permitted under Title 26 U.S.C.A., Section 56.

V.

That at all times hereinafter set forth, the plaintiff was carrying on the business of insuring titles to real property for compensation in the business commonly known as a title insurance business, and said business is subject to the Insurance Code of the State of Oregon, being Title 101 O.C.L.A. Sections 101-101 through 101-1803. That under said Insurance Code of the State of Oregon, Section 101-136 provides in part:

"The insurance commissioner shall, whenever

he deems it advisable in the interest of policy-holders or for the public good, examine into the affairs of any insurance company, agency, corporation, partnership, person or persons engaged in * * * the insurance business in this state * * *. It shall be the duty of the insurance commissioner to examine every domestic insurance company at least once in three years."

That Section 101-137 O.C.L.A. provides as follows:

"Examination: Reserve: Liability: (Formulating or adopting rules). In ascertaining the condition of an insurance company under the provisions of this act, or in any examination made by the insurance commissioner, his deputy, or examiner, he shall allow as assets only such investments, cash and accounts as are authorized by the laws of this state at the date of the examination, or under the existing laws of the state or country under which such company is organized and which investment he may approve or reject, but unpaid premiums on policies written within three months shall be admitted as available resources. In ascertaining his liabilities, unless otherwise provided in this act, there shall be charged the capital stock, all outstanding claims, a sum equal to the total unearned premiums on the policies in force computed on a pro rata basis, and such an amount as may be found necessary as a reserve to provide for the future payment of deferred and undetermined claims for losses and promised

benefits. In determining the amount of such reserve or unearned premium liability, the insurance commissioner, his deputy or examiner may formulate such rules as he may deem proper and consistent with law or he may adopt such rules as are used in other states or approved by the national convention of insurance commissioners.''

VI.

That during the year 1945, the Insurance Commissioner of the State of Oregon examined plaintiff's business under and by virtue of Section 101-136 O.C.L.A. and on January 12, 1946, pursuant to the authority vested in him and by virtue of Section 101-137 O.C.L.A., he orderd the plaintiff to establish, segregate and maintain an unearned premium of reinsurance reserve as hereafter provided, which shall at all times and for all purposes be deemed and shall constitute unearned portions of the premiums and shall be charged as a reserve liability of the corporation in its statements; such reserve shall be cumulative and consist of the following:

(a) As at December 31, 1945, or within a period of three years thereafter an amount equal to 3% of the total gross fees and premiums received or to be received on account of policies issued during the four calender years—1942, 1943, 1944 and 1945; and

(b) Monthly at the close of each month beginning January, 1946, 3% of the total gross fees and premiums received or to be received on account of policies written during the preceding calendar month;

(c) After the expiration of 180 months from January 1, 1942, that portion of the unearned premiums or reinsurance reserve established more than 180 months prior shall be released and shall no longer constitute part of the unearned premium or reinsurance reserve and may be used for any corporate purpose.

VII.

That the Insurance Code of the State of Oregon provides that no insurance company may operate in the State of Oregon without first having obtained a license from the Insurance Commissioner of the State of Oregon; that in the event of the violation of any orders of the Insurance Commissioner or law of the State of Oregon, said Commissioner may revoke said license.

VIII.

That under and by virtue of the request of the Insurance Commissioner of the State of Oregon, the plaintiff set up a reserve on its return for the year 1945 in accordance with a directive of the said Insurance Commissioner of 3% of its gross premiums for the calendar years 1942, 1943, 1944 and 1945 of $18,614.63 as an allowable reserve under Title 26, U.S.C.A., Section 204.

IX.

That after said return was filed, the Commissioner of Internal Revenue caused same to be audited. That thereupon the said Commissioner, by deficiency letter dated November 2, 1948, adjusted the amount of gross and net income reported in plaintiff's said re-

turn. That the Commissioner of Internal Revenue thereby determined that plaintiff was subject to an additional income tax for the calendar year 1945 in the amount of the claimed deficiency of $15,979.27. That such deficiency was computed by the Commissioner by disallowing $18,665.58 in which disallowance was included: taxes of $35.95 and anticipated expenses of $15.00 and adjusting said net income from $67,470.72 to $86,136.30 and adjusting the excess profits net income of $48,168.61 and deducting an over-assessmeent of $32.96, or a total adjustment of net income in the amount of $86,136.30 instead of $67,470.72 as originally reported on said return by plaintiff.

X.

That said determination is erroneous and illegal in that $15,979.27 was reserve ordered by the Insurance Commissioner of the State of Oregon by virtue of the laws of the State of Oregon to cover unearned premiums and policies written for the years 1942, 1943, 1944 and 1945 and which reserve is set aside and taken away from the jurisdiction of the Board of Directors and is not available as surplus or for the payment of dividends to Stockholders for a minimum period of 15 years.

XI.

That pursuant to said deficiency letter, the Commissioner of Internal Revenue erroneously and illegally assessed plaintiff in the additional amount of said alleged deficiency of $15,979.27. That on February 28, 1949, plaintiff paid to the defendant the

entire amount of said assesement, to wit: the sum of $15, 979.27 and on March 22, 1949, in addition thereto, plaintiff paid accrued interest to date in the amount of $2,825.92.

XII.

That on the 20th day of June, 1949, plaintiff filed a claim for refund for $15,979.27 plus said $2,825.92 interest on said sum, with the Collector of Internal Revenue for the District of Oregon as required by and pursuant to 26 U.S.C.A., Section 3772 (a) (1), on Form 843 prescribed by the Commissioner of Internal Revenue pursuant to 26 U.S.C.A., Section 3901 (2), a copy of which is hereto attached marked Exhibit "A," referred to and made a part hereof. That plaintiff herein realleges all the matters and things contained in said claim for refund. That more than six months have elapsed since the filing of said claim and no notice of allowance or disallowance has been received from the Commissioner of Internal Revenue.

Wherefore, plaintiff demands judgment against the defendant for the sum of $18,805.19 together with interest at the rate of 6% per annum and for its costs and disbursements incurred herein.

/s/ WILL H. MASTERS,
Attorney for Plaintiff.

EXHIBIT A

Claim

To Be Filed With the Collector Where Assessment Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse.

- ☐ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

State of Oregon,
County of Multnomah—ss.

Name of taxpayer: Pacific Abstract Title Co.
Business address: 408 S. W. Oak Street, Portland, Oregon.
Residence: State of Oregon.

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed: District of Oregon.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1945, to Dec. 31, 1945.

3. Character of assessment or tax: Corporation excise profit tax.

4. Amount of assessment $15,979.27; dates of payment Feb. 28, 1949. $2,825.92, interest, March 22, 1949.

5. Date stamps were purchased from the Government ....

6. Amount to be refunded: $18,805.19 $18,805.19

7. Amount to be abated (not applicable to income, gift, or estate taxes) ....$.........

8. The time within which this claim may be legally filed expires, under section 3772-2 of Internal Revenue Code on November 2, 1950.

The deponent verily believes that this claim should be allowed for the following reasons:

The Insurance Commissioner of the State of Oregon, upon examination of our business for the year 1945, ordered us as of December 31st, 1945, to reduce our earnings in an amount equal to 3% of the total gross fees and premiums received on account of policies of insurance issued during the four calendar years, 1942, 1943, 1944, 1945, and to set up monthly at the close of each month, beginning January 1st, 1946, 3% of the total gross fees and premiums received or to be received on account of policies of insurance written during the preceding calendar month. The Insurance Commissioner based his authority to order this under the provision of Section 101-136, O.C.L.A. We were, therefore, compelled under the law and under the order of the

Insurance Commissioner to reduce our earnings accordingly; otherwise, the Insurance Commissioner would refuse to issue a permit to us to do business.

The Insurance Commissioner of the State of Oregon has jurisdiction and authority over all accounting and financial transactions that we have in order to insure the financial protection of all policyholders. The order of the Insurance Commissioner of the State of Oregon is so comprehensive that this amount of earnings is set aside and taken away from the jurisdiction of the Board of Directors and is not available to us as a surplus or for the payment of dividends to stockholders for a minimum period of 15 years.

We, therefore, submit that this resreve has been created under the laws of the State of Oregon and that said tax has been illegally assessed and collected.

Subscribed and sworn to before me this 15th day of June, 1949.

..........................,

Notary Public for Oregon.

My Commission expires:

/s/ PACIFIC ABSTRACT TITLE CO.

By ....,

President.

By ....,

Secretary.

[Title of District Court and Cause.]

ANSWER

The defendant, the United States of America, by its attorney, Henry L. Hess, United States Attorney for the District of Oregon, for answer to the complaint herein states:

I.

Admits the allegations contained in paragraphs I, II, III, IV, and V of the complaint.

II.

Denies the allegations contained in paragraph VI of the complaint, except that defendant admits that the Insurance Commissioner of the State of Oregon ordered plaintiff to establish, segregate, and maintain an unearned premium reserve which shall be cumultaive and consist of the following:

(a) As at December 31, 1945, or within a period of three years thereafter an amount equal to 3% of the total gross fees and premiums received or to be received on account of policies issued during the four calendar years—1942, 1943, 1944 and 1945; and

(b) Monthly at the close of each month beginning January, 1946, 3% of the total gross fees and premiums received or to be received on account of policies written during the preceding calendar month;

(c) After the expiration of 180 months from January 1, 1942, that portion of the unearned premiums or reinsurance reserve established more than 180 months prior shall be released and shall no

longer constitute part of the unearned premium or reinsurance reserve and may be used for any corporate purpose.

III.

Denies the allegations contained in paragraph VII of the complaint, except that defendant admits that the Insurance Code of the State of Oregon provides that no insurance company may operate in that state without first having obtained license from the Insurance Commissioner of that state.

IV.

Admits the allegations contained in paragraphs VIII and IX of the complaint, except that defendant avers that plaintiff's excess profits net income for the calendar year 1945 as adjusted by the Commissioner of Internal Revenue was $48,160.61 instead of $48,168.61.

V.

Denies each and every allegation contained in paragraph X of the complaint.

VI.

Denies the allegations contained in paragraph XI of the complaint, except that defendant avers that on February 28, 1949, plaintiff paid to Hugh H. Earle, Collector of Internal Revenue for the District of Oregon the sum of $15,979.27, representing the deficiency determined by the Commissioner of Internal Revenue with respect to the calendar year 1945, and on March 24, 1949, plaintiff paid to said Collector accrued interest on said deficiency in the amount of $2,825.92.

VII.

For answer to paragraph XII of the complaint, defendant admits that on June 20, 1949, plaintiff filed a claim for refund of $15,979.27, representing the deficiency in excess profits tax determined with respect to the calendar year 1945 and interest thereon in the amount of $2,825.92 with the Collector of Internal Revenue for the District of Oregon, and that Exhibit A attached to the complaint herein is a true copy of said claim for refund, but defendant denies each and every allegation contained in said claim for refund not specifically hereinbefore admitted or denied, except that defendant admits that more than six months have elapsed since the filing of said refund claim and no action thereon has been taken by the Commissioner of Internal Revenue.

VIII.

Denies each and every allegation contained in the complaint not hereinbefore specifically admitted or denied.

Wherefore, the defendant prays that the complaint be dismissed and that the defendant be given judgment in its favor, together with the costs and disbursements of this action.

HENRY L. HESS,
United States Attorney
Attorney for United
States.

THOMAS R. WINTER,
Special Assistant to the Attorney General.

/s/ VICTOR E. HARR,
Assistant United States Attorney.

United States of America,
District of Oregon—ss.

I, Victor E. Harr, Assistant United States Attorney for the District of Oregon, hereby certify that I have made service upon the plaintiff of the foregoing Answer of Defendant by depositing in the United States Post Office at Portland, Oregon, on the 21st day of April, 1950, a duly certified copy thereof, enclosed in an envelope, with postage thereon prepaid, addressed to Will H. Master, Yeon Building, Portland 4, Oregon, Attorney of record for plaintiff.

/s/ VICTOR E. HARR,
Assistant United States Attorney.

[Endorsed]: Filed April 21, 1950.

[Title of District Court and Cause.]

PRE-TRIAL ORDER

This cause coming on for pre-trial before the Hon. James Alger Fee, United States District Judge, on July 12, 1950, plaintiff being represented by Will H. Masters, its attorney, and defendant being represented by Henry L. Hess, United States Attorney, and Victor E. Harr, Assistant United States Attorney.

Based upon proceedings had at said pre-trial, it is hereby

Ordered that the following matters are admitted as to the issues framed by the complaint herein and by the answer to the complaint and by the parties and may be deemed as facts established in the case.

I.

That plaintiff is a citizen of the United States residing at Portland, Oregon. That this action is brought in this Court under the jurisdiction and by virtue of Title 28, U.S.C.A., Section 1340 and Section 1346, to recover money alleged to have been erroneously and illegally assessed and collected.

II.

That during all times hereinafter set forth, J. W. Maloney was the duly appointed, qualified and acting Collector of Internal Revenue for the District of Oregon and the person who collected the allegedly erroneous and illegally assessed tax, but that said J. W. Maloney is no longer in office as Collector of Internal Revenue for the District of Oregon.

III.

That plaintiff was required to and did under oath, file its income and excess profits returns on Form 1120 and 1121 on or before the 15th day of April, 1946, for the calendar year 1945 with the Collector of Internal Revenue at Portland, Oregon, copies of the returns are pre-trial Exhibit 3.

IV.

It is agreed that the Court shall take judicial notice of the laws of Oregon.

V.

During the year 1945 the Insurance Commissioner of the State of Oregon through his duly apointed agents examined plaintiff's business, and on January 12, 1946, mailed the plaintiff a letter, pre-trial Exhibit 1, which letter was duly received by plaintiff.

VI.

That on or about November 22, 1948, the Commissioner of Internal Revenue determined that the exclusion shown in the return of $18,614.63 as a reserve set up by plaintiff on its books, as of December 31, 1945, was improper and excluded the amount of the reserve in determining the plaintiff's tax liability for the calendar year 1945. The Commissioner recomputed plaintiff's income tax liability on the basis of the adjustment and determined a deficiency in plaintiff's income tax liability for the calendar year 1945 in the amount of $15,979.27, which deficiency was duly assessed against plaintiff and

was paid with accrued interest of $2,825.92 on March 22, 1949, to J. W. Maloney, Collector of Internal Revenue. Said Collector is no longer in office.

VII.

Plaintiff set up on its books, as aforementioned, on December 31, 1945, a reserve for purported unearned premiums as follows:

3 per cent of 1942 premiums....	$ 2,780.17
3 per cent of 1943 premiums....	3,885.46
3 per cent of 1944 premiums....	4,829.59
3 per cent of 1945 premiums....	7,119.41
Total Reserve..............	$18,614.63

VIII.

Plaintiff filed on or about June 20, 1949, a claim for refund, pre-trial Exhibit 5. More than six months elapsed from the filing of the claim and institution of this suit.

IX.

Pursuant to Section 101-1501 and 101-1502, O.C.L.A., the plaintiff deposited with the Treasurer of the State of Oregon securities of the value of $100,000.00, and that such deposit was made many years prior to 1945 and is unrelated to the reserve set up on the books of the company and referred to in the letter of the Insurance Commissioner dated January 12, 1946.

Disputed Facts

Plaintiff alleges and defendant denies the following:

That the rule requiring segregation and main-

tenance of an unearned premium or reinsurance reserve to be set up by the plaintiff as set forth in the letter of January 12, 1946, to the plaintiff by the Insurance Commissioner of the State of Oregon, was promulgated on December 26, 1945, by the Insurance Commissioner of the State of Oregon. That prior to that time plaintiff had been informed by the Insurance Commissioner of the State of Oregon that the rule would be made in the year 1945, and informed plaintiff what the rule would contain, and that said rule would apply to all title insurance companies in the State of Oregon. That in December, 1945, plaintiff had seen the rule as set forth in a letter by the Insurance Commissioner of the State of Oregon to the Title and Trust Company, dated December 26, 1945, pre-trial Exhibit 2.

Issue

Did the Commissioner of Internal Revenue err in not allowing plaintiff to exclude from its taxable income for the year 1945 the amount of $18,614.63 constituting the purported reserve set up on its books in compliance with the direction of the Insurance Commissioner of the State of Oregon?

Contentions of Plaintiff

I.

Plaintiff contends that the sum of $18,614.63 is an allowable reserve as defined in Section 204 (b) (s) of the Internal Revenue Code.

II.

That the plaintiff is an insurance company under the laws of the State of Oregon and is subject to all

the rules and regulations and laws of the State of Oregon with reference to insurance companies.

III.

That plaintiff was ordered by the Insurance Commissioner of the State of Oregon under the laws of the State of Oregon with reference to insurance companies on December 26, 1945, to set up on its books as of December 31, 1945, a reserve of 3 per cent of its gross premiums for 180 months as a reserve for unearned premiums or reinsurance reserve.

IV.

That the Insurance Commissioner of the State of Oregon had authority under the laws of the State of Oregon to order said reserve to be set up upon the books of the plaintiff and removed from the jurisdiction of the Board of Directors.

V.

That the exclusions of said reserve from our taxable income was properly shown in 1945 for the reason that that time our liability thereunder was definitely fixed.

Contentions of Defendant

I.

That the so-called directive of the Commissioner of Insurance was invalid and unenforceable under the laws of the State of Oregon.

II.

If it is held that the direction of the Commissioner of Insurance is valid and enforceable under

Oregon law, it is ineffectual insofar as plaintiff's taxable income for 1945.

III.

In the event the Commissioner of Insurance's direction to set up the reserve was lawful and equivalent to a statutory requirement and if the retroactive aspect of the case does not defeat the deduction, plaintiff is still not entitled to exclude from its taxable income for the calendar year 1945 the full amount of the reserve of $18,614.63 since the reserve was set up to cover the taxable years 1942, 1943, 1944 and 1945. In other words, if plaintiff is entitled to a deduction on account of the reserve, the deduction should be spread over the years from 1942 to 1945 inclusive.

IV.

The reserve is not of the character allowable as an exclusion under the revenue statutes.

V.

In adopting Section 204 of the Internal Revenue Code, Congress intended to provide for a general or "nation-wide" system of taxation for insurance "other than life or mutual." It did not and has not manifested an intention that so-called "directives" issued by state officials from time to time to individual companies doing business in their respective states shall be taken into consideration in determining the income tax liability of companies which received them.

Exhibits

It Is Ordered that the parties may offer in evi-

dence at the trial of this action any and all of the following pre-trial exhibits without further identification or authentication, each of the parties, however, having reserved the right to object on other grounds to the admission in evidence of any or all said exhibits, to wit:

Plaintiff's Pre-Trial Exhibits

Exhibit Number 1—Letter of January 12, 1946, from Insurance Commissioner of Oregon to plaintiff.

Exhibit Number 2—Letter of December 26, 1945, from Insurance Commissioner of Oregon to Title and Trust Co.

Exhibit Number 3—Income and Declared Value Excess Profits tax returns of the plaintiff for the calendar year 1945, Forms 1120 and 1121.

Exhibit Number 4—90-day deficiency letter with statement attached from the Commissioner of Internal Revenue to plaintiff, dated November 2, 1948.

Exhibit Number 5—Claim for refund for year 1945.

Exhibit Number 6—Schedule of Gross Fees received by the plaintiff for the period 1942-1945, inclusive.

Exhibit Number 7—Copy of Annual Statement to Insurance Commissioner of the State of Oregon (conventional form) for the calendar years 1942, 1943, 1944 and 1945.

Exhibit Number 8—Specimen forms of title insurance policies used by plaintiff during the period involved.

Exhibit Number 9—Agent's report dated Feb. 6, 1948.

It is further ordered and agreed that this pre-trial order will govern the course of the trial and will not be amended except by consent or to prevent manifest injustice. This pre-trial order will take the place of the pleadings. The parties agree to waive a jury and have the case tried before the Court sitting without a jury.

The Court, finding that the foregoing clearly and accurately reflects the pre-trial conference had herein and the stipulations and agreements of the parties, hereby ratifies and confirms the foregoing proceedings in all things, and does hereby

Order that the said pre-trial order be and the same is hereby incorporated into and hereby made a part of the record in this case for the purpose of controlling the course of proceedings on the formal trial hereof before the Court.

Dated this 12th day of July, 1950.

/s/ JAMES ALGER FEE,
District Judge.

Approved:

/s/ WILL H. MASTERS,
Of Attorneys for Plaintiff.

/s/ VICTOR E. HARR,
Of Attorneys for Defendants.

[Endorsed]: Filed July 12, 1950.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause coming on for hearing before the Honorable Gus J. Solomon, Judge of the above-entitled Court, on the 13th day of July, 1950, and the plaintiff appearing by its attorney, Will H. Masters of Masters & Masters, and the defendant appearing by Henry L. Hess, United States District Attorney for the District of Oregon, and James P. Garland, Special Assistant to the Attorney-General of the United States, and the Court after hearing the evidence on the part of the plaintiff and defendant and the arguments of counsel and being fully advised in the premises, makes the following:

Findings of Fact

I.

That plaintiff is a citizen of the United States, residing at Portland, Oregon. That this action is brought in this Court under the jurisdiction and by virtue of Title 28, U.S.C.A., Section 1340 and Section 1346, to recover money erroneously and illegally assessed or collected.

II.

That during all times hereinafter set forth, J. W. Maloney was the duly appointed, qualified and acting Collector of Internal Revenue for the District of Oregon and the person who collected the erroneous and illegally assessed tax, but that said J. W.

Maloney is no longer in office as Collector of Internal Revenue for the District of Oregon.

III.

That plaintiff was required to and did under oath, file its income and excess profits returns on Forms 1120 and 1121 on or before the 15th day of April, 1946, for the calendar year 1945, with the Collector of Internal Revenue at Portland, Oregon.

IV.

That during the year 1945, the Insurance Commissioner of the State of Oregon, through his duly appointed agents, examined plaintiff's books and on January 12, 1946, ordered the plaintiff, under and by virtue of Sections 101-136 and 101-137, O.C.L.A., to establish, segregate and maintain an unearned premium of reinsurance reserve which shall at all times and for all purposes constitute unearned portions of the premiums and shall be charged as a reserve liability of the corporation in its statements; such reserve shall be accrued and consist, as at December 31, 1945, for the years 1942, 1943, 1944 and 1945, of an amount equal to 3% of the total gross fees and premiums received or to be received on account of policies issued during said calendar years, and thereafter monthly at the close of each month, beginning January, 1946, 3% of the total gross fees and premiums received or to be received on account of policies written during the preceding calendar month, and after the expiration of 180 months from January 1, 1942, that

portion of the unearned premiums or reinsurance reserve established more than 180 months prior shall be released and shall no longer constitute part of the unearned premium or reinsurance reserve and may be used for any corporate purpose.

V.

That in December, 1945, the Insurance Commissioner of the State of Oregon informed plaintiff that said reserve would have to be set up as of December 31, 1945, and on December 26, 1945, the Title and Trust Company, Portland, Oregon, was ordered to set said reserve up and said order was shown to the plaintiff. That said Insurance Commissioner of the State of Oregon, in December, 1945, informed plaintiff that said order would be made as to all title insurance companies in the State of Oregon.

VI.

That on or about November 22, 1948, the Commissioner of Internal Revenue determined that the exclusion shown in the return of $18,614.63 as a reserve set up by plaintiff on its books, as of December 31, 1945, was improper and excluded the amount of the reserve in determining the plaintiff's tax liability for the calendar year 1945. The Commissioner recomputed plaintiff's income tax liability on the basis of the adjustment and determined a deficiency in plaintiff's income tax liability for the calendar year 1945 in the amount of $15,979.27, which deficiency was duly assessed against plaintiff and was paid with accrued interest of $2,825.92 on

March 24, 1949, to J. W. Maloney, Collector of Internal Revenue, which Collector is no longer in office.

VII.

Plaintiff set up on its books, as aforementioned, on December 31, 1945, a reserve for purported unearned premiums as follows:

3% of 1942 premiums..........	$ 2,780.17
3% of 1943 premiums..........	3,885.46
3% of 1944 premiums..........	4,829.59
3% of 1945 premiums..........	7,119.41
Total Reserve	$18,614.63

VIII.

That on or about June 20, 1949, plaintiff filed a claim for refund on the ground that said reserve was legally set up by the State of Oregon and was taken away from the jurisdictional authority of the Board of Directors and was not available to said plaintiff as a surplus or as payment of dividends to the stockholders. That more than six months have elapsed since the filing of said claim and the institution of action herein.

IX.

That pursuant to Sections 101-1501 and 101-1502, O.C.L.A., plaintiff deposited with the Treasurer of the State of Oregon securities in the value of $100,000.00 and that said deposit was made many years prior to 1945 and is unrelated to the reserve set up on the books of the company.

From the foregoing Findings of Fact, the Court makes the following:

Conclusions of Law

I.

That the plaintiff was an Insurance Company under the Insurance Laws of the State of Oregon and the Commissioner of Insurance of the State of Oregon had jurisdiction over said plaintiff; that said Insurance Commissioner of the State of Oregon had authority under the laws of the State of Oregon to order said reserve to be set up on the books of the plaintiff and remove from the jurisdiction of the Board of Directors the said sum of $18,614.63 as an allowable reserve as defined in Section 204 (b) (s) of the Internal Revenue Code.

II.

That the exclusion of the reserve from plaintiff's taxable income was properly shown as of December 31, 1945.

III.

That the Commissioner of Internal Revenue erred in excluding said reserve as a reserve and including the same in income.

IV.

That plaintiff is entitled to recover from the defendant the sum of $18,805.19 together with interest

at the rate of 6% per annum from February 28, 1945.

Dated this 17th day of November, 1950.

/s/ GUS J. SOLOMON,
Judge.

State of Oregon,
County of Multnomah—ss.

Due and legal service of the within Findings of Fact and Conclusions of Law by receipt of a duly certified copy thereof, as required by law, is hereby accepted in Multnomah County, Oregon, on this 9th day of November, 1950.

/s/ VICTOR E. HARR,
Of Attorneys for Defendant.

[Endorsed]: Filed November 17, 1950.

In the United States District Court
for the District of Oregon
Civil Action No. 5290

PACIFIC ABSTRACT TITLE CO., a Corporation,

Plaintiff,

vs.

UNITED STATES,

Defendant.

JUDGMENT

This cause coming on for trial before the Honorable Gus J. Solomon, Judge of the above-entitled

Court, on the 13th day of July, 1950, and the plaintiff appearing by its attorney, Will H. Masters of Masters & Masters, and the defendant appearing by Henry L. Hess, United States District Attorney for the District of Oregon, and James P. Garland, Special Assistant to the Attorney-General of the United States, and based upon the Findings of Fact and Conclusions of Law herein, it is hereby

Ordered and Adjudged, that the plaintiff have and recover of and from the defendant the sum of $18,805.19 together with interest as provided by law.

Dated and Entered this 17th day of November, 1950.

/s/ GUS J. SOLOMON,
Judge.

[Endorsed]: Filed November 17, 1950.

[Title of District Court and Cause.]

NOTICE OF APPEAL

To: Pacific Abstract Title Co., plaintiff, and Will H. Masters, its attorney:

Notice is hereby given that the United States of America, defendant above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit, from the Judgment entered in this action on the 17th day of November, 1950, in favor of plaintiff and against defendant.

Dated this 9th day of January, 1951, at Portland, Oregon.

HENRY L. HESS,
United States Attorney for the District of Oregon.

/s/ VICTOR E. HARR,
Assistant United States Attorney.

[Endorsed]: Filed January 11, 1951.

[Title of District Court and Cause.]

MOTION FOR EXTENSION OF TIME

Comes now the defendant above named, by and through its attorneys, Henry L. Hess, United States Attorney for the District of Oregon, and Victor E. Harr, Assistant United States Attorney, and moves the Court for an order extending the time for filing the record on appeal and docketing the within action in the Circuit Court of Appeals to ninety days from the first date of filing of said Notice of Appeal. This motion is based on the grounds that the Department of Justice requires additional time to fully consider said appeal.

Dated at Portland, Oregon, this 12th day of February, 1951.

HENRY L. HESS,
United States Attorney for the District of Oregon.

/s/ VICTOR E. HARR,
Assistant United States Attorney.

[Endorsed]: Filed February 13, 1951.

[Title of District Court and Cause.]

ORDER

This matter coming on to be heard ex parte this day upon motion of defendant, through its attorneys, Henry L. Hess, United States Attorney for the District of Oregon, and Victor E. Harr, Assistant United States Attorney, for an order extending time for the filing of the record on appeal and docketing the within action in the Circuit Court of Appeals, to enable the Department of Justice to have additional time to consider said appeal, and the Court being fully advised in the premises,

It Is Ordered that the time for filing the within appeal and docketing the action be, and it is hereby, extended to ninety days from the first date of the Notice of Appeal.

Made and Entered at Portland, Oregon, this 13th day of February, 1951.

/s/ GUS J. SOLOMON,
District Judge.

[Endorsed]: Filed February 13, 1951.

In the United States District Court
for the District of Oregon

Civil No. 5290

PACIFIC ABSTRACT TITLE CO., a Corporation,

Plaintiff,

vs.

THE UNITED STATES,

Defendant.

DOCKET ENTRIES

1950

Mar. 1—Filed complaint.

Mar. 1—Issued summons—to marshal.

Mar. 8—Filed summons with marshal's return.

Mar. 15—Filed affidavit of Will H. Masters re service by mail.

Apr. 21—Filed answer.

May 15—Entered order setting for trial on September 19, 1950—10 a.m.

May 22—Entered order resetting for trial on June 6, 1950—10 a.m.

June 8—Entered order striking from trial calendar.

June 23—Entered order setting for trial July 13, 1950.

June 26—Filed motion of U. S. for judgment on the pleadings.

July 12—Filed and entered pre-trial order.

July 13—Record of trial before court and order continuing to July 17, 1950—2 p.m.

July 17—Filed stipulation re testimony of A. C. Olshen.

1950

July 17—Entered order allowing withdrawal of motion of U. S. for judgment on the pleadings; record of further trial and order allowing ptff. 20 days to submit brief; deft. 20 days thereafter and ptff. 10 days thereafter and order reserving.

Aug. 1—Filed brief of plaintiff.

Aug. 12—Filed transcript of testimony at trial July 13, 1950.

Aug. 17—Filed stipulation for time for U. S. to file brief.

Aug. 17—Filed and entered order allowing U. S. to and including Sept. 15 to file brief.

Sept. 15—Filed brief for the United States.

Sept. 25—Filed stipulation re time for pltf. to file reply brief.

Sept. 25—Filed and entered order extending time to and inc. Oct. 2, 1950, to file reply brief.

Oct. 2—Filed reply brief of plaintiff.

Oct. 31—Record of oral opinion and order that pltf. prepare Findings, Conclusions and Judgment.

Nov. 9—Filed exhibits Nos. 7a to 7d, inc.

Nov. 17—Filed and entered Findings of Fact and Conclusions of Law.

Nov. 17—Filed and entered judgment.

1951

Jan. 11—Filed notice of appeal by U. S. Copy to Atty. Masters.

Feb. 13—Filed motion for order extending time for filing and docketing appeal.

1951

Feb. 13—Filed and entered order extending time for filing and docketing appeal.

Apr. 6—Filed designation of record.

CERTIFICATE OF CLERK

United States of America,
District of Oregon—ss.

I, Lowell Mundorff, Clerk of the United States District Court for the District of Oregon, do hereby certify that the foregoing documents, consisting of complaint, answer, motion for judgment on the pleadings, pre-trial order, stipulation re testimony of A. C. Olshen, Findings of Fact and Conclusions of Law, Judgment, Notice of Appeal, motion for extension of time to file record, order extending time to file record on appeal, designation of contents of record on appeal, and transcript of docket entries, constitute the record on appeal from a judgment of said court therein numbered Civil 5290, in which the Pacific Abstract Title Co., a corporation, is plaintiff and appellee, and the United States of America is defendant and appellant; that the said record has been prepared by me in accordance with the designation of contents of record on appeal filed by the appellant, and in accordance with the rules of this court.

In Testimony Whereof I have hereunto set my

hand and affixed the seal of said court in Portland, in said District, this 7th day of April, 1951.

[Seal] LOWELL MUNDORFF,
Clerk.

By /s/ F. L. BUCK,
Chief Deputy.

PRE-TRIAL EXHIBIT No. 1

State of Oregon
Department of Insurance
Fire Marshal Department
Salem

January 12, 1946

Pacific Abstract Title Company,
408 S. W. Oak Street,
Portland 4, Oregon.

Dear Sirs:

Pursuant to Section 101-136, O. C. L. A., an examination of your Company was made as of September 30, 1945, by a duly authorized examiner of this department. Enclosed herewith is a copy of the examination report.

On page 16 of said report attention is called to the advisability of making adequate reserve provision for unearned premiums. Study has been given by the Department towards the formulation of a reasonable, adequate, and sound rule for the determination of such a reserve. Consideration was given to the trend of your experience, premium

volume, and size and types of risks underwritten. In order to make broader comparison with the requirements and procedures followed in other states as regards such reserves, the statutes of the various states were analyzed. As a consequence, in accordance with the provisions of Section 101-137, O. C. L. A., the following rule has been promulgated as applicable to your Company.

1. The Pacific Abstract Title Company shall establish, segregate and maintain an unearned premium or reinsurance reserve as hereafter provided, which shall at all times and for all purposes be deemed and shall constitute unearned portions of the premiums and shall be charged as a reserve liability of your corporation in your statements; such reserve shall be cumulative and shall be established and shall consist of the following:

(a) As at December 31, 1945, or within a period of three years thereafter an amount equal to 3% of the total gross fees and premiums received or to be received on account of policies issued during the four calendar years—1942, 1943, 1944 and 1945; and

(b) Monthly at the close of each month beginning January, 1946, 3% of the total gross fees and premiums received or to be received on account of policies written during the preceding calendar month;

(c) After the expiration of 180 months from January 1, 1942, that portion of the unearned premium or reinsurance reserve established more than 180 months prior shall be

released and shall no longer constitute part of the unearned premium or reinsurance reserve and may be used for any corporate purposes.

2. Hereafter the Pacific Abstract Title Company shall segregate and maintain a "Title Loss Reserve" at least equal to the aggregate estimated amount due or to become due on account of all unpaid losses and claims upon title insurance policies of which the company has received notice but not less than the aggregate of title losses incurred during the immediately preceding 36 months.

3. Hereafter the Pacific Abstract Title Company shall not issue a policy of title insurance for a single transaction, the face amount of which shall exceed an amount which is five times the capital and surplus of your Company; but nothing herein shall prevent the Pacific Abstract Title Company from assuming the risk on a single policy jointly with another title insurance company or companies in excess of five times the Pacific Abstract Title Company's capital and surplus, provided that the total amount of such insurance shall not exceed five times the total combined capital and surplus of all such companies liable under such insurance; and provided that each such company shall not assume more than its proportionate share of the total amount at risk in accordance with the above-defined maximum retention limit.

If at any date subsequent hereto, upon review or examination as provided in the Oregon Insurance Laws, it is determined that the reserves and pro-

cedures established by the rules as promulgated above are inadequate for the safety and welfare of the policyholders and not in the best interests of the company operations, said rules will be modified as necessary; furthermore should any statute hereafter be adopted by the State of Oregon bearing on this subject, then any sections of these rules inconsistent or in conflict with said statute or statutes shall be automatically voided.

Yours very truly,

/s/ S. B. THOMPSON,
Insurance Commissioner.

SBT:LM

Note: Carbon copy of letter delivered to
J. A. Givens, 9/2/47.
gie

PRE-TRIAL EXHIBIT No. 4

Treasury Department
Internal Revenue Service
Seattle 1, Washington

November 2, 1948

Office of Internal Revenue Agent in Charge,
Seattle Division,
305-A Jones Building,
1331 Third Avenue.
IT:90D:EEH

Pacific Abstract Title Co.,
408 S. W. Oak Street,
Portland, Oregon.

Gentlemen:

You are advised that the determination of your excess profits tax liability for the year ended December 31, 1945, discloses a deficiency of $16,012.23, and that the determination of your income tax liability for the year mentioned discloses an overassessment of $32.96, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington

25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Seattle 1, Washington, for the attention of IT:90D:EEH. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

GEO. J. SCHOENEMAN,
Commissioner.

By /s/ S. R. STOCKTON,
Internal Revenue Agent in Charge.

Enclosures:
Statement
Form of waiver
EEH:EGG

IT:90D:EEH

STATEMENT
Pacific Abstract Title Co.
408 S. W. Oak Street
Portland, Oregon

Tax Liability for the Taxable Year Ended December 31, 1945.

	Liability	Assessed	Over-assessment	Deficiency
Income Tax	$13,627.11	$13,660.07	$32.96	
Excess Profits Tax	$41,177.32	$25,165.09		$16,012.23

In making this determination of your income and excess profits tax liability, careful consideration has been given to the report of examination dated November 10, 1947; to your protest dated February 26, 1948; and to the statements made at the conferences held on July 7, 1948, and October 6, 1948.

A copy of this letter and statement has been mailed to your representative, Mr. Will H. Masters, Yeon Building, Portland, Oregon, in accordance with the authority contained in the power of attorney executed by you.

Adjustments to Net Income

Net income as disclosed by return, Form 1120		$67,470.72
Unallowable deductions and additional income:		
(a) Taxes	$ 35.95	
(b) Anticipated expenses	15.00	
(c) Unearned premiums	18,614.63	18,665.58
Net income, adjusted		$86,136.30

Explanation of Adjustments

(a) On your return you claimed a deduction of $623.77 for State and County taxes, assessed as of January 1, 1945, and payable in November, 1945. It is held that the deduction for these taxes is allowable in the amount of $587.82, and your net income is increased by the difference of $35.95 in the amounts shown.

(b) On your return you claimed a deduction of $15.00 for City licenses. As your liability for the payment of these licenses had not been determined as of the end of the taxable year, the claimed deduction is disallowed and your net income is increased by the amount shown.

(c) In your income and declared value excess profits tax return for the year 1945 you reported title insurance premiums in the amount of $218,698.90. The records of this office show that in addition to this sum you received title insurance premiums in the amount of $18,614.63 which you credited to a reserve for unearned premiums and did not include in gross or net income reported.

The Bureau holds that the total title insurance premiums received by you during the year 1945 were earned in that year. Taxable income reported has, therefore, been increased by the sum of $18,614.63.

Income Tax Computation

Net income, adjusted			$86,136.30
Less: Adjusted excess profits net income			48,160.61
Normal-tax net income and surtax net income			$37,975.69
Normal-tax:	$ 5,000.00 @ 15%	$ 750.00	
	15,000.00 @ 17%	2,550.00	
	5,000.00 @ 19%	950.00	
	12,975.69 @ 31%	4,022.46	
Total normal-tax			$ 8,272.46
Surtax:	$25,000.00 @ 10%	$2,500.00	
	12,975.69 @ 22%	2,854.65	
Total surtax			$ 5,354.65
Income tax liability (normal tax and surtax)			$13,627.11
Income tax assessed: Original, Account No. 4100720			13,660.07
Overassessment of income tax			$ 32.96

Adjustments to Excess Profits Net Income

Excess profits net income as disclosed by return (Form 1121)	$67,470.72
Additions:	
(a) Adjustments to net income	18,665.58
Excess profits net income, corrected	$86,136.30

Explanation of Adjustment

(a) Your excess profits net income is increased by the total amount of the additions made to the net income reported on your return, Form 1120, as explained above.

Excess Profits Tax Computation

Excess profits net income, corrected		$86,136.30
Less: Specific exemption	$10,000.00	
Excess profits credit as determined	27,975.69	37,975.69
Adjusted excess profits net income		$48,160.61
Excess profits tax, 95% of $48,160.61		$45,752.58
Less: 10% credit Section 784, I.R.C.		4,575.26
Correct excess profits tax liability		$41,177.32
Previous assessment—Original, Account No. 4000283		25,165.09
Deficiency in excess profits tax		$16,012.23

PRE-TRIAL EXHIBIT No. 6

Abstracts — Title Insurance — Escrows

Pacific Abstract Title Co.
408 S.W. Oak Street, Portland, Oregon

Schedule of: Gross Fees Received
Period Covered: 1942-1945 incl. May 29, 1950

	1942	1943	1944	1945	Total
Premiums for:					
Title Insurance	$ 92,672.32	$129,515.35	$ 94,896.52	$144,739.00	$461,823.19
Fees for:					
Abstracts				8,411.00	8,411.00
Escrows				1,239.80	1,239.80
Other	8,847.05	12,951.65	11,817.43	3,797.25	37,413.38
Totals:	$101,519.37	$142,467.00	$106,713.95	$158,187.05	$508,887.37

[Shown in pencil on original under 1944 total: 66,089.83 totaling 172,803.78.]

Footnote: The foregoing figures were taken from the Annual Statement to the Insurance Commissioner of the State of Oregon.

PRE-TRIAL EXHIBIT No. 8

Pacific Abstract Title Co.
408 S. W. Oak Street,
Portland, Oregon

$ Premium $ No.

Owner's Title Insurance Policy

For value, Pacific Abstract Title Co., a corporation (incorporated under the laws of the State of Oregon and duly authorized by the State Insurance

Commissioner to insure titles in said state), hereinafter called the Company,

Does Hereby Insure

subject to the annexed conditions, hereby made a part of this policy,

[Stamped]: Specimen.

heirs and devisees (or if a corporation, its successors) hereinafter called the Insured, against loss or damage not exceeding

Dollars,

which the Insured may sustain by reason of any defects in or unmarketability of the Insured's title to all the estate or interest in the premises specified and hereinafter described or by reason of liens or encumbrances charging the same at the date of this policy, saving and excepting, and this policy does not insure against loss or damage by reason of any estate or interest, defect, lien, encumbrance or objection hereinafter set forth in annexed Schedule B.

Any loss under this policy is to be established in the manner provided in said conditions and shall be paid upon compliance by the insured with and as prescribed in said conditions, and not otherwise.

In testimony whereof, Pacific Abstract Title Co. has caused these presents to be duly signed by its President or Vice-President, attested by its Secretary or Assistant Secretary, under its Corporate seal this

PACIFIC ABSTRACT TITLE CO.,

By /s/ WILL H. MASTERS, President.

Attest:

Secretary.

Page 1 of Policy No.

Schedule A

The Estate or interest covered by this policy:

Description of the tract of land the title to which is insured by this policy:

[Stamped]: Specimen.

Page 2 of Policy No.

Schedule B

This policy does not insure against:

1. Any state of facts which an accurate survey and inspection would show; roads, ways and easements not established of record; the existence of county roads; water rights and water locations.

2. Rights or claims of persons in possession, or claiming to be in possession, not shown of record; material or labor liens of which no notice is of record.

3. Matters relating to assessments, if any, preceding the same becoming fixed and shown as a lien; taxes not yet payable, and all matters relating to vacating, opening or other changing of streets or highways preceding the final termination of the same.

4. Provisions and effect of any law or ordinance enacted for the purpose of regulating occupancy or

use of said land or any building or structure thereon.

[Stamped]: Specimen.

Page .. of Policy No.

Conditions

Upon receipt of notice of any defect, lien or incumbrance hereby insured against, the Insured shall forthwith notify the Company thereof in writing. In case any suit, action or proceeding is commenced to which the Insured is a party and which may result in loss under this policy, the Insured shall immediately after learning thereof notify the Company in writing, and within ten (10) days after service of process upon him secure to the Company the right to defend such suit, action or proceeding in the name of the Insured, so far as necessary to protect the Insured, and shall render all reasonable assistance in such defense. The Company will defend such suit, action or proceeding at its own cost, reserving, however, the option of settling the claim or paying this policy in full at any time. But the Company shall in no case be liable for any costs or expense incurred by the Insured in such litigation without its consent.

In the event of final judicial determination by a Court of competent jurisdication, under which the Insured is dispossessed or deprived of the real estate covered hereby, or his estate or interest insured is impaired by reason of any adverse interest, lien or incumbrance hereby insured against, or, if

this policy covers a mortgagee's interest, if such final judicial determination shall defeat or impair the mortgagor's title to all or any part of the mortgaged premises or establish the priority to the mortgage of a lien or incumbrance not excepted in this policy, claim may be made hereunder, provided, the conditions have been in all ways complied with. Every claim for loss under this policy must be in writing, giving a full statement thereof, and be delivered to the Company at its Home Office within sixty (60) days after such final judicial determination, whereupon the loss hereunder shall be payable to the Insured on or before thirty (30) days.

The Company may at any time pay this policy in full, whereupon all liability of the Company shall terminate. The total liability under this policy, exclusive of costs, shall in no case exceed the face of the policy, and every payment of the Company shall reduce the policy by the amount paid. When the Company shall have paid a loss under this policy it shall be subrogated to all rights and remedies which the Insured may have against any person or property in respect of such claims, or would have if this policy had not been issued, and the Insured shall forthwith transfer all such rights to the Company accordingly. If the payment made by the Company does not cover the loss of the Insured, then such subrogation of the Company shall be proportionate. Or, the Company may, in case this policy covers a mortgagee's interest only, pay the Insured the entire mortgage indebtedness, with interest at the rate specified in the mortgage and thereupon the Insured

shall assign and transfer to the Company the mortgage and the indebtedness thereby secured, with all instruments evidencing or securing the same, or shall convey to the Company any estate lawfully vested in the Insured by virtue of foreclosure of the mortgage, and all liability of the Company shall thereupon terminate.

Where the Insured, in good faith, shall have entered into an enforceable contract, in writing, to sell the insured estate or interest, and the title shall have been rejected because of some defect or incumbrance not excepted in this policy, and notice in writing of such rejection shall have been given to this Company within ten days thereafter; for thirty days after receiving such notice this Company shall have the option of paying the loss of which the Insured must present proper proof, or of maintaining or defending either in its own name or at its option in the name of the Insured some proper action or proceeding, begun or to be begun in a court of competent jurisdiction, for the purpose of determining the validity of the objection alleged by the vendee to the title, and only in case a final determination is made in such action, or proceeding, sustaining the objection to the title, shall this Company be liable on this policy.

If this policy covers a mortgagee's interest only, discharge of the mortgage, otherwise than through foreclosure thereof, or by deed in lieu of foreclosure, shall terminate this policy and all liability of the Company hereunder; but if any Insured acquires said land, or any part thereof, by fore-

closure or in any other legal manner in satisfaction of said mortgage indebtedness, or any part thereof, then this policy shall continue in force in favor of such Insured and each successor in interest in ownership, subject to all of the conditions and stipulations hereof applicable to an owner of land.

Nothing contained in this policy shall be construed as an insurance against defects or incumbrances created subsequent to the date hereof.

[Endorsed]: No. 12894. United States Court of Appeals for the Ninth Circuit. United States of America, Appellant, vs. Pacific Abstract Title Co., a corporation, Appellee. Transcript of Record. Appeal from the United States District Court for the District of Oregon.

Filed April 9, 1951.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals
for the Ninth Circuit

No. 12894

Civil Action No. 5290

PACIFIC ABSTRACT TITLE CO., a Corporation,

Plaintiff,

vs.

UNITED STATES,

Defendant.

STATEMENT OF POINTS TO BE RELIED ON BY DEFENDANT-APPELLANT ON APPEAL

Comes now the United States of America, the defendant-appellant in the above-entitled cause, and states that the points upon which it intends to rely in its appeal are as follows:

The United States District Court for the District of Oregon erred:

1. In concluding that the insurance commissioner of the State of Oregon had authority under the laws of that state to order the plaintiff to set up on its books on December 31, 1945, a reserve for purported unearned premiums computed as follows:

Three per cent of its 1942 premiums.....	$ 2,780.17
Three per cent of its 1943 premiums.....	$ 3,885.46
Three per cent of its 1944 premiums.....	$ 4,829.59
Three per cent of its 1945 premiums.....	$ 7,119.41
Total Reserve	$18,614.63

and also erred in concluding that the insurance commissioner of Oregon had authority to remove from the jurisdiction of the Board of Directors of the plaintiff the said sum of Eighteen Thousand, Six Hundred, Fourteen Dollars and Sixty-three Cents ($18,614.63), and erred further in concluding that said amount so computed was an allowable reserve as defined in Section 204(b)(5) of the Internal Revenue Code.

2. In concluding that the exclusion of the aforesaid sum of $18,614.63 from plaintiff's taxable income for the calendar year 1945 was properly shown as of December 31, 1945.

3. In concluding that the Commissioner of Revenue erred in excluding said sum of $18,614.63 as a reserve and including it in plaintiff's taxable gross income for the calendar year 1945.

4. In concluding that plaintiff is entitled to recover from the defendant the sum of $18,805.19 paid by plaintiff as federal income tax for the calendar year 1945, together with interest thereon at the rate of six per cent per annum from February 28, 1945.

5. In failing to find and hold that the aforesaid sum of $18,614.60 computed by plaintiff in accordance with the order or directive of the insurance commissioner of the State of Oregon did not constitute unearned premiums of the plaintiff, or a reserve therefor; and in failing to hold that that amount was not allowable as a reserve within the

terms of Section 204(b)(5) of the Internal Revenue Code.

6. In failing to hold that the Commissioner of Internal Revenue did not err in including the aforesaid amount of $18,614.60 in plaintiff's taxable gross income for the calendar year 1945.

7. In failing to render judgment against the plaintiff and in favor of the defendant, and in failing to dismiss the action.

/s/ HENRY L. HESS,
United States Attorney, Attorney for Defendant-Appellant.

United States of America,
District of Oregon—ss.

I, Victor E. Harr, Assistant United States Attorney for the District of Oregon, hereby certify that I have made service upon the plaintiff of the foregoing Statement of Points to Be Relied On by Defendant-Appellant on Appeal by depositing in the U. S. Post Office at Portland, Oregon, on the 13th day of April, 1951, a duly certified copy thereof, enclosed in an envelope, with postage thereon prepaid, addressed to Mr. Will H. Masters, Attorney at Law, Yeon Building, Portland 4, Oregon, attorney of record for plaintiff.

/s/ VICTOR E. HARR,
Assistant United States Attorney.

[Endorsed]: Filed April 16, 1951.

[Title of Court of Appeals and Cause.]

NOTICE AS TO STATEMENT OF POINTS TO BE RELIED UPON BY APPELLANT AND AS TO PARTS OF RECORD TO BE PRINTED

Pursuant to Rule 19(6) of the Rules of Practice of the United States Court of Appeals for the Ninth Circuit, notice is hereby given by the United States of America, appellant on review herein, as follows:

1. The United States hereby adopts, as the Statement of Points upon which it intends to rely in the present appeal, the Statement of Points heretofore filed with the United States District Court for the District of Oregon, and included in the certified typewritten transcript of record filed in this Court in this case;

2. The United States hereby designates for printing the following parts of the record filed in this Court in this cause:

a. Complaint.

b. Defendant's Answer to Complaint.

c. District Court's pre-trial order.

d. Plaintiff's pre-trial exhibits numbered 1, 4, 6 and 8.

e. District Court's findings of fact and conclusions of law.

f. Judgment order.

g. Notice of appeal.

h. Motion asking District Court for extension of time to file record on appeal.

i. Order of District Court entered February 13, 1951, granting 90-day extension of time to file record on appeal.

j. Statement of Points to be relied upon by appellant, filed with District Court.

k. Docket entries.

l. Notice as to Statement of Points, etc., filed by appellant with this Court; and

m. This notice and designation.

/s/ THERON L. CAUDLE,

Assistant Attorney General,
Counsel for Appellant.

[Endorsed]: Filed April 23, 1951.

No. 12894

In the United States Court of Appeals for the Ninth Circuit

UNITED STATES OF AMERICA,
Appellant,
v.
PACIFIC ABSTRACT TITLE CO., a Corporation,
Appellee.

On Appeal from the United States District Court for the District of Oregon

BRIEF FOR THE UNITED STATES

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OPINION BELOW

The District Court did not write any formal opinion but made special findings of fact and conclusions of law which are not officially reported. These findings of fact and conclusions of law will be found in the record (pp. 25-30).

JURISDICTION

This appeal involves federal income tax for the year 1945 in the amount of $18,805.19, plus interest. The tax in controversy was a deficiency determined by the Commissioner of Internal Revenue after audit of the taxpayer's income tax return for the calendar year 1945 in the amount of $15,979.27, which deficiency was duly paid with accrued interest of $2,825.92 on March 24, 1949, to J. W. Maloney, then Collector of Internal Revenue for the District of Oregon, which Collector is no longer in office. (R. 27-28.) Taxpayer filed a claim for refund of the tax involved in this controversy on or about June 20, 1949. (R. 28.) The Commissioner of Internal Revenue has not acted on taxpayer's claim for refund and at the time this action was instituted in the District Court more than six months had elapsed since the filing of taxpayer's claim for refund. (R. 28.)

Within the time provided in Section 3772 of the Internal Revenue Code and on March 1, 1950, the taxpayer filed a complaint in United States District Court for the District of Oregon for the recovery of the tax paid involved in this

controversy. (R. 3, 12, 34.) Jurisdiction was conferred on the District Court by 28 U. S. C., Section 1346 (a)(1). Judgment was entered for the taxpayer on November 17, 1950. (R. 30-31.) Within sixty days and on January 11, 1951, a notice of appeal was filed. (R. 31-32.) The jurisdiction of this Court is necessarily invoked under 28 U. S. C., Section 1291.

QUESTION PRESENTED

Whether the District Court erred in allowing the taxpayer, a title insurance company, an exclusion from its gross underwriting income for the taxable year 1945 under Section 204 (b) (5) of the Internal Revenue Code in the amount of $18,614.63, representing 3% of the total title insurance premiums received by taxpayer on account of title insurance contracts written by it during the four calendar years 1942 to 1945, inclusive.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations involved will be found in the Appendix, *infra,* pp.

STATEMENT

The undisputed facts as found by the District Court (R. 25-28) and as set forth in the pleadings (R. 3-15) may be briefly summarized as follows:

Taxpayer is a domestic corporation and a citizen of the United States residing at Portland, Oregon. (R. 25.) At all the times herein involved, the taxpayer was carrying on the business of insuring titles to real property for compensation in the business commonly known as a title insurance business, and was subject to the Insurance Code of the State of Oregon, being 7 Oregon Compiled Laws Annotated (1940 ed.), Sections 101-101 through 101-1803. (R. 4, 13.)

During the year 1945, the Insurance Commissioner of the State of Oregon, through his duly appointed agents, examined taxpayer's books and on January 12, 1946, ordered it under and by virtue of Sections 101-136 and 101-137, Oregon Compiled Laws Annotated, to establish, segregate and maintain an unearned premium of reinsurance reserve which shall at all times and for all purposes constitute unearned portions of the premiums and shall be charged as a reserve liability of the corporation in its statement. The Insurance Commissioner ordered that such reserves shall be accrued and consist, as at December 31, 1945, for the years 1942, 1943, 1944 and 1945, of an amount equal to 3% of the total gross fees and premiums received or to be received by taxpayer on account of policies issued during those calendar years, and thereafter monthly at the close of each month, beginning Janaury, 1946, 3% of the total gross fees and premiums received or to be received on account of policies written during the preceding calendar month, and after the expiration of 180 months from January 1, 1942,

that portion of the unearned premiums or reinsurance reserves established more than 180 months prior shall be released and shall no longer constitute part of the unearned premium or reinsurance reserve and may be used for any corporate purpose. (R. 26-27.) Accordingly, taxpayer set upon its books, as aforementioned, on December 31, 1945, a reserve for purported unearned premiums as follows: 3% of 1942 premiums, $2,780.17; 3% of 1943 premiums, $3,-885.46; 3% of 1944 premiums, $4,829.59; 3% of 1945 premiums, $7,119.41. Total reserves, $18,614.63. (R. 28.)

On or about November 22, 1948, the Commissioner of Internal Revenue determined that the exclusion shown in taxpayer's income tax return for the calendar year 1945 of the $18,614.63, aforementioned, as a reserve set up by taxpayer on its books as of December 31, 1945, was improper and excluded the amount of the reserve in determining the taxpayer's tax liability for the calendar year 1945. The Commissioner recomputed the taxpayer's income tax liability for the year 1945 on the basis of the adjustment, aforementioned, and determined a deficiency in income tax for that year in the amount of $15,979.27, which deficiency in tax was duly assessed and was paid with accrued interest of $2,825.92 on March 24, 1949, to J. W. Maloney who was then Collector of Internal Revenue. (R. 27-28.)

On or about June 20, 1949, taxpayer filed a claim for refund of the deficiency in income tax collected from it for

the calendar year 1945, together with the interest assessed thereon, on the ground that the reserve which it was required to set up in accordance with the directive of the Insurance Commissioner of Oregon was legally set up by the State of Oregon and was taken away from the jurisdictional authority of the board of directors of the taxpayer and, therefore, was not available to it as surplus or for the payment of dividends to its stockholders. (R. 28.) At the time the suit was instituted in the District Court, more than six months had elapsed since the filing of the taxpayer's claim for refund upon which that suit was predicated. (R. 28.)

STATEMENT OF POINTS TO BE URGED

In the present appeal, the United States urges and relies upon all of the points originally stated by it (R. 52-54) and subsequently adopted by it in this Court (R. 55) as the points upon which it intends to rely. For present purposes, they may be briefly summarized as follows:

1. The District Court erred in concluding that the Insurance Commissioner of Oregon had authority under the laws of Oregon to order the taxpayer to set up on its books as of December 31, 1945, the reserve in question, in the amount of $18,614.63, as a purported reserve for "unearned premiums", computed upon the taxpayer's premiums for the years 1942 to 1945, inclusive.

2. The District Court erred in concluding that the amount of the reserve in question was an allowable reserve under Section 204 (b) (5) of the Internal Revenue Code.

3. The District Court erred in concluding that the Commissioner of Internal Revenue was in error in restoring the amount of the reserve in question to the taxpayer's gross income for the year 1945, in determining the taxpayer's tax liability for that year.

4. The District Court erred in failing to hold that the amount of $18,614.63 computed by the taxpayer in accordance with the directive of the Insurance Commissioner of Oregon did not constitute "unearned premiums" and was not allowable as a reserve under Section 204 (b) (5) of the Internal Revenue Code.

SUMMARY OF ARGUMENT

Congress intended the words "unearned premiums", as used in Section 204 (b) (5) of the Internal Revenue Code, to be given their usual and ordinary meaning as known and understood in the business of insurance—namely, that portion of the premium received which the company had not had time to earn during the taxable year. The taxpayer's reserve, which it was required to set up by the directive of the Insurance Commissioner of the State of Oregon, did not constitute "unearned premiums" within the meaning of Section 204 (b) (5) of the Internal Revenue Code.

The title insurance policies issued by the taxpayer during the calendar years involved do not contain any requirement or provision for the return to the policyholder of any portion of the premium collected. The applicable provisions of the Insurance Code of Oregon, upon which the Insurance Commissioner acted, do not define "unearned premiums" in the case of title insurance companies; and do not require the taxpayer to maintain a "reserve" for unearned premiums. The Oregon Insurance Code merely provides that in ascertaining the condition of an insurance company and in ascertaining its liabilities there shall be charged, among other things, a sum equal to the total unearned premiums on policies in force computed on a pro rata basis, and such an amount as may be found necessary as a reserve to provide for the future payment of deferred and undetermined claims for losses and promised benefits. In the case of title insurance, the entire premium is earned when the policy is issued. Accordingly, to the extent that the Insurance Commissioner's directive purported to impose the burden of maintaining an unearned premium reserve upon this taxpayer, it clearly transcended the power which the Oregon legislature delegated to him. Moreover, it was beyond the power of the Insurance Commissioner after the close of the calendar year 1945 to convert *retroactively* any portion of premiums previously fully earned by the taxpayer into unearned premiums held by it at the beginning and end of each of the calendar years 1942 to 1945, inclusive.

ARGUMENT

The taxpayer was not entitled to a deduction under Section 204 (b)(5) of the Internal Revenue Code for the reserve required to be maintained by the directive of the Insurance Commissioner of Oregon purportedly as a reserve for "unearned premiums".

We are dealing in this case with a title insurance corporation organized under the laws of the State of Oregon which has, since its formation, been engaged in the business of insuring the owners of real estate, or those having interest in real estate by mortgage, or otherwise, from loss by reason of defective titles, liens or incumbrances.

It is no longer open to question that companies guaranteeing land titles for a consideration are taxable as insurance companies. *United States* v. *Home Title Co.,* 285 U. S. 191. The taxpayer in the case at bar for the calendar years 1942, 1943, 1944 and 1945 was taxable for federal income tax purposes under the provisions of Section 204 of the Internal Revenue Code (Appendix, *infra*) as an insurance company, other than life or mutual.

The controversy in this case involves the construction of Section 204 of the Internal Revenue Code. That section of the Code was derived from Section 246 of the Revenue Act of 1921, c. 136, 42 Stat. 227. The section was re-enacted, without material change, in each of the subsequent Revenue Acts to and including the Revenue Act of 1938, and on

February 10, 1939, was incorporated into the Internal Revenue Code.

The general scheme of Section 204 of the Code is to divide the income of insurance companies subject to tax thereunder into three groups, namely, the investment income, underwriting income, and all other income. Only the taxpayer's underwriting income is involved in this case, and the particular problems in controversy relate to the computation of "premiums earned." Paragraph (4) of subsection (b) of Section 204 defines "underwriting income" as the "premiums earned" less "losses incurred" and "expenses incurred." Paragraph (5) defines "premiums earned" as "an amount computed as follows":

> "From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year. * * *"

Thus, in order to compute "premiums earned" during the taxable year, it is necessary to reflect the net changes during the year in the amount of "unearned premiums." The particular issue in controversy in this case is as to whether the reserve in question constituted "unearned premiums" at all, so as to permit the increase therein during the taxable year—i.e., the entire amount of $18,614.63, inasmuch as there was no such reserve at the beginning of the

year—to be used to reduce "premiums earned" during the taxable year.

The controversy also involves the construction, validity, and enforceability of the so-called directive contained in a letter dated January 12, 1946, addressed to this taxpayer by the Insurance Commissioner of Oregon. The pertinent provisions of this so-called directive read as follows (R. 38-39, Pre-Trial Ex. 1):

> "1. The Pacific Abstract Title Company shall establish, segregate and maintain an unearned premium or reinsurance reserve as hereafter provided, which shall at all times and for all purposes be deemed and shall constitute unearned portions of the premiums and shall be charged as a reserve liability of your corporation in your statements; such reserve shall be cumulative and shall be established and shall consist of the following:
>
> (a) As at December 31, 1945 or within a period of three years thereafter an amount equal to 3% of the total gross fees and premiums received or to be received on account of policies issued during the four calendar years—1942, 1943, 1944 and 1945; and
>
> (b) Monthly at the close of each month beginning January, 1946, 3% of the total gross fees and premiums received or to be received on account of policies written during the preceding calendar month;
>
> (c) After the expiration of 180 months from January 1, 1942, that portion of the unearned premium or reinsurance reserve established more than 180 months prior shall be released and shall no longer constitute

> part of the unearned premium or reinsurance reserve and may be used for any corporate purposes. (R. 37-40, Pre-Trial Ex. 1.)"

There is involved here the effectuality of the Insurance Commissioner's directive in respect to the determination of this taxpayer's taxable income from insurance business for the taxable year 1945 under Section 204 of the Internal Revenue Code.

We are also concerned here with the interpretation and extent of the delegated powers conferred upon the Oregon Insurance Commissioner by the Oregon Insurance Code. (7 Oregon Compiled Laws Annotated, Sections 101-105, 101-136, 101-137 and 101-138 (Appendix, *infra*)).

1. Congress, in enacting Section 246 (b) (5) of the Revenue Act of 1921, and the corresponding provisions of subsequent Revenue Acts including Section 204 (b) (5) of the Internal Revenue Code, intended the words "unearned premiums" to be given their usual and ordinary meaning as known and understood in the business of insurance. In *DeGanay* v. *Lederer*, 250 U.S. 376, 381, it is said:

> "Unless the contrary appears, statutory words are presumed to be used in their ordinary and usual sense, and with the meaning commonly attributable to them."

There is nothing in the section here under consideration to show that Congress used the words "unearned premiums" in other than their usual and ordinary sense as known and understood in the business of insurance.

The word "premium" as applied to insurance contracts has been defined as "the price or amount paid for insurance" (Funk & Wagnall's Standard Dictionary), or as "the consideration paid for a contract of insurance" (Bouvier's Law Dictionary); while the word "unearned" is defined in Webster's New International Dictionary (1933) to mean "not earned; not gained by labor or service."

A good statement of the meaning of "unearned premiums" was made in *Aetna Ins. Co.* v. *Hyde,* 315 Mo. 113, 133, where the words were held to mean that portion of the premium paid by the policyholder which must be returned on cancellation of the policy, and which is in direct proportion to the unexpired time which the policy is to run. The court said (p. 133):

> "They are paid in advance for service to be thereafter rendered. *That is, it is what a company must repay when it cancels a policy.*" (Italics supplied.)

Solomon S. Huebner, Ph.D., professor of insurance and commerce, University of Pennsylvania, in his work, Property Insurance, c. XIV, pp. 153-154, puts it this way:

> "Thus let us suppose that a company issues an annual policy for a premium of $120. This premium is payable in advance, and since the policy has a year to run, it is clear that the company has not yet earned this sum, but will become entitled to it only in the proportion that the policy reaches its maturity. At the end of the first month one-twelfth of the term has elapsed, and the company can rightfully consider that

part of the premium, or $10, as earned. Eleven-twelfths of the premium, however, or $110, must be considered unearned, since the company has not yet furnished protection for the eleven months remaining in the term. At the end of six months one-half of the premium, or $60, is earned, and the other half unearned. It is not until the end of the twelfth month that the company has furnished the full year's insurance, and is, therefore, entitled to the full premium.

This unearned portion of the premium constitutes the reserve. It must be regarded as a sum held in trust by the company for its policyholders. Although paid to it in advance, the company cannot claim this sum as its own property. It belongs to the policyholders, and must be earned by the company before it can be used for its own purposes. The reinsurance reserve may thus be defined as 'the unearned premium'; or as the liability of the company to its policyholders for that portion of the premium already collected, but not yet earned.[1]"

That the words "unearned premiums" in insurance and actuarial circles had a well-known and commonly understood meaning when Congress enacted the Revenue Act of 1921 will not, it is believed, be disputed. These words were generally known and understood to mean that portion of the premium paid for the unexpired portion of the term, which the company had not yet had time to earn.

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[1] While Professor Huebner was here discussing the unearned premium of a fire insurance company, the same principles apply to all casualty insurance, including accident and health insurance.

In speaking of "This unearned portion of the premium", Professor Huebner remarked:

> "It belongs to the policyholders, and must be earned by the company before it can be used for its own purposes."

Clearly, the converse must be true. If any portion of the "premium" *does not belong to the policyholder,* then it must belong to the company.

An inspection of the form of title insurance policies issued by the taxpayer during the period here involved (R. 45-51, Pre-Trial Ex. 8) will disclose that this policy did not contain any requirement or provision for the return to the policyholder of any portion of the premium collected. So, we submit that no portion of the taxpayer's premiums written on insurance contracts during the period involved in this law suit could be "unearned" as the insured was not entitled to any return of the premiums so collected. Since, in the case at bar, a policyholder has no claim against the taxpayer for the return of any portion of his premium *qua* premium, it seems clear that the premium, when paid, must belong to the insurance company, and hence, is fully earned when paid.

The position of the court below is erroneously based on the fallacious premise that the so-called directive of the Insurance Commissioner of Oregon effectually and retroactively converted into "unearned premiums" in 1945 portions of the premiums previously collected and actually earned

by the taxpayer during the years 1942 and 1944, inclusive, as well as portions of those collected and earned by it during the calendar year 1945.

The provisions of Section 204 (b)(5) of the Internal Revenue Code which in effect require the division of premiums charged by insurance companies into earned and unearned premiums are not applicable to title companies whose premiums are earned in full at the time their policies are issued. Earnings of title companies are returnable for income tax purposes in the year the charge for their services is made, if, like the taxpayer here, they keep their books and make their income tax returns on the accrual basis of accounting. *American Title Co.* v. *Commissioner,* 76 F. 2d 332 (C.A. 3d), affirming 29 B.T.A. 479; *North American Reassurance Co.* v. *Commissioner,* 29 B.T.A. 683; *Commissioner* v. *Dallas Title & Guar. Co.,* 119 F. 2d 211 (C.A. 5th); *City Title Ins. Co.* v. *Commissioner,* 152 F. 2d 859 (C.A. 2d). Cf. *Massachusetts Protective Ass'n* v. *United States,* 114 F. 2d 304 (C.A. 1st).

In *Massachusetts Protective Ass'n* v. *United States, supra,* the Court of Appeals called attention to the difference between the nature of the business conducted by certain kinds of insurance companies, other than life or mutual, based on the character and length of the risks against which the policyholder was insured. See, for example, the following excerpt from the court's opinion in the case (p. 312):

> "Whether a premium is considered earned or unearned depends upon the nature of the risk and policy involved. *American Title Co.* v. *Commissioner,* 1933, 29 B.T.A. 479, affirmed 3 Cir., 1935, 76 F. 2d 332. Fire and ordinary casualty insurance premiums become fully earned as soon as the period for which the premium was paid has expired, for the risk expires at the same time; but a title insurance premium is fully earned the moment it is paid although the risk continues indefinitely. *American Title Co.* v. *Commissioner, supra.* See Mass. Gen. Laws (Ter. Ed. 1932) c. 175, Sec. 10; Huebner, Property Insurance (1927) 355."

Again, in *American Title Co.* v. *Commissioner,* the Board of Tax Appeals said (p. 481):

> "Unlike other insurance, such as life, fire, etc., which protect the insured against future events, title insurance merely guarantees against a future disclosure of unfavorable circumstances existing at the time of the deed."

In view of the inherent nature of the risk against which title companies insure their policyholders, it is not possible to allocate a part of the premium charged for a policy to "unearned premiums" and set it up in a so-called *unearned premium reserve* upon any basis of fact. Cf. *Commissioner* v. *Dallas Title & Guar. Co., supra.*

Under Section 204 of the Internal Revenue Code, the total of the taxpayer's gross fees involved represents income which was fully earned and *accrued* during the year 1945. See Section 204 (b) (1) which defines gross income. And,

of course, it is needless to reiterate that all *gross fees* charged by the taxpayer in 1942, 1943, 1944 and 1945 were fully earned at the time it (1) performed the service, or (2) assumed the risks for which it billed its policyholders. *American Title Co.* v. *Commissioner,* 76 F. 2d 332 (C.A. 3d), affirming 29 B.T.A. 479.

2. Sections 101-136, 101-137, and 101-138 of the Oregon Compiled Laws Annotated, which relate to insurance laws generally, frequently called the Oregon Insurance Code, do not require the taxpayer to maintain a "reserve" for unearned premiums. The applicable provisions of that insurance code, upon which the Insurance Commissioner of Oregon acted, do not define "unearned premiums" in the case of title insurance companies. That insurance code merely provides that in ascertaining the condition of an insurance company and in ascertaining its liabilities there shall be charged, among other things, a sum equal to the total unearned premiums on policies in force computed on a pro rata basis, and such an amount as may be found necessary as a reserve to provide for the future payment of deferred and undetermined claims for losses and promised benefits. Accordingly, we submit that, to the extent that the Insurance Commissioner's directive purported to impose the burden upon this taxpayer, a title insurance company, of maintaining an unearned premium reserve, that directive clearly transcended the power which the Oregon Legislature delegated to him.

Avoiding the temptation to apply technical tests for construing statutes to the language the lawmakers employed in framing Sections 101-136, 101-137 and 101-138 of the Oregon Insurance Code, and applying to it merely the usual and ordinary meaning of the language used, it seems to be reasonably clear that the only authority the State of Oregon delegated to its Insurance Commissioner was: (1) to make examinations; (2) to ascertain the assets and liabilities of the insurance companies according to standards prescribed; and (3) with the assistance of the courts to take steps against those companies which the Commissioner ascertained to be insolvent or in unsound condition. We think the employment of the term "unearned premiums" in Section 101-137 is not indicative of any principles to the contrary.

The directive of the Oregon Insurance Commissioner which was issued on January 12, 1946, after this taxpayer had earned its premiums with respect to business written during the calendar years 1942, 1943, 1944 and 1945 purported to divest this taxpayer of a part of those premiums upon the supposititious fiction that a portion of the premiums collected belonged to the policyholders and should be held in trust for such policyholders. While it is true that Section 101-137 of the Oregon Insurance Code provides that in determining the *amount* of "unearned premiums", the Insurance Commissioner, his deputy or examiner may formulate such rules as he may deem proper and consistent

with law or he may adopt such rules as are used in other states or approved by the National Convention of Insurance Commissioners, certainly that authority did not confer upon the Insurance Commissioner the power to convert retroactively, after the close of the calendar year 1945, any part of premiums previously fully earned by the taxpayer into unearned premiums held by it at the beginning and end of each of the calendar years beginning with 1942 through 1945. So, we maintain that the Insurance Commissioner's directive of January 12, 1946, was an attempt to legislate and not merely to exercise an administrative function or discretion which the Oregon Insurance Code conferred upon him, and therefore is void. *Sunshine Dairy* v. *Peterson,* 183 Or. 305.

In that case, the Sunshine Dairy questioned the authority of the Director of Agriculture to fix minimum wholesale and retail prices for milk as charged by producers, distributors, and dealers, etc., under the state Milk Control Act. The Act conferred very broad powers upon the director, but the Supreme Court of Oregon held, nevertheless, in a lengthy opinion which reviewed most of the state and federal authorities, that the directive exceeded the authority of the director. In the course of its opinion, the court referred to one of its earlier decisions in the following manner (p. 327):

> "In the more recent case of *Layman* v. *State Unemployment Compensation Commission,* 167 Or. 379, 117

P. (2d) 974, 136 A.L.R. 1468, the court said:

> " 'It is an elementary and fundamental principle, which no one will dispute, that a commission, created by the legislature to administer a statute, is wholly limited in its powers and authority by the law of its creation. No more unwholesome doctrine could be suggested than that such a body is vested with discretion to ignore or transgress these limitations even to accomplish what it may deem to be laudable ends. That would be to leave room for that "play and action of purely personal and arbitrary power" condemned in *Yick Wo* v. *Hopkins,* 118 U. S. 356, 6 S. Ct. 1064, 30 L. Ed. 220, 226. If the statute as written is not workable, then the remedy is with the legislature. * * *' "

Cf. *Social Security Board* v. *Nierotko,* 327 U. S. 358, holding that where Government officials interpret a statute so as to make it apply to particular circumstances as a delegation of legislative power, their directives must have a basis in law and must be within the authority granted; and *Bartels* v. *Birmingham,* 332 U. S. 126, which holds that an interpretative ruling of the Commissioner of Internal Revenue that a statement in a contract for services between the operator of a place of amusement and the leader of a band of musicians, that the former is the employer of the musicians and their leader, and shall have complete control of the services to be rendered by them, makes such operator liable as the employer for the employment tax imposed under the Social Security Act, exceeds the statutory power of the Commissioner.

Section 101-137 of the Oregon Insurance Code merely gives the Insurance Commissioner authority to determine the *amount* of unearned premiums in the case of insurance companies which, unlike title insurance companies, do have "unearned premiums" because of the nature of their business. As to those companies the statute leaves it to the Insurance Commissioner to determine a formula upon which to calculate the portion of their premiums which is unearned and which is to be set aside as a reserve, and that is not an improper delegation of powers. Cf. *Field* v. *Clark,* 143 U. S. 646, 694. See also, *Van Winkle* v. *Fred Meyer, Inc.,* 151 Ore. 455, 462.

The question whether there has been an improper delegation of legislative power to an administrative official or body is always made to turn on whether the legislature has fixed a proper standard for their guidance. Cf. *State* v. *Briggs,* 45 Or. 366; *State Ex Rel.* v. *Malheur County Court,* 185 Or. 392, 422; *Pittsburgh Glass Co.* v. *Labor Board,* 313 U. S. 146; *American Power Co.* v. *S. E. C.,* 329 U. S. 90.

As the terms "reserve" or "reserves", including "unearned premium reserve," have a well established meaning in the field of insurance, (*Maryland Casualty Co.* v. *United States,* 251 U. S. 342, 351), the Oregon legislature must be deemed to have used those terms in Section 101-137, Oregon Compiled Laws Annotated, in their established technical sense, and that left no room for the Insurance Commissioner to declare any portion of the premiums of title companies

to be "unearned premiums". So, when the Insurance Commissioner undertook to direct this taxpayer, a title insurance company, to set up the disputed reserve, we submit that he exceeded his authority, as the Social Security Board did in the case of *Social Security Board* v. *Nierotko,* 327 U. S. 358, in that the Insurance Commissioner of Oregon erroneously ruled that a portion of the premiums collected by title insurance companies was unearned.

The intention of Congress controls on the question of whether the federal or state law is to be applied. *Helvering* v. *Stuart,* 317 U. S. 154. Manifestly, the mere declaration that a thing is a fact when the evidence which must be offered in its support discloses the contrary to be the case, is not binding on the Commissioner of Internal Revenue. *Early* v. *Lawyers Title Ins., Corp.,* 132 F. 2d 42 (C.A. 4th).

The text of the Virginia Statute is quoted by the Court of Appeals in the *Early* case (p. 43) and reads as follows:

> "(e) On any contract of title insurance, hereafter issued by a domestic title insurance company, there shall be reserved initially a sum equal to ten per centum of the original premium, whether or not the risk shall be for a fixed time. If for a fixed time, then at the end of each year for the first five years, there shall be a reduction in the sum reserved of one per centum of the original premium, and thereafter at the end of each year of the remainder of said time a reduction of a pro-rata portion of the remaining five per centum thereof, except that if the risk is of a mortgagee, trustee in a deed of trust to secure debt, or creditor secured thereby,

> no reduction shall be made that will decrease the sum reserved below five per centum of the original premium, until the expiration of the time of the risk. If not for a fixed time, then a risk shall be deemed to have been written, if of an owner of property, or any interest therein, for twenty years from the date of the contract, and if of a mortgagee, trustees in a deed of trust to secure debt, or creditor secured thereby, for a time expiring three years after the final maturity of the debt as stated in the mortgage or deed of trust, or for twenty years from the date of the contract, whichever time shall be longer. On any contract of title insurance heretofore issued, a reserve shall be set up and hereafter maintained, in such sum as would have been required if the above requirements had existed at and after the date of the contract. *Said sums, herein required to be reserved for unearned premiums on contracts of title insurance shall at all times and for all purposes be considered and constitute unearned portions of the original premiums.* In calculating reserves, contracts of title insurance shall be assumed to be dated in the middle of the year in which they were issued." (Italics supplied.)

In the course of its opinion in the *Early* case, the Court of Appeals for the Fourth Circuit said: (1) That ordinarily a premium paid for title insurance is to be treated as fully earned when received, citing *American Title Co.* v. *Commissioner,* 76 F. 2d 332 (C.A. 3d), affirming 29 B.T.A. 479, and Huebner, Property Insurance, c. XXX, p. 493, and (2) That in the absence of a statute comparable to that of Virginia, it would feel constrained to hold that no part of the premiums paid by the taxpayer could be treated as "un-

earned" within the meaning of the revenue laws. After stating that a state statute could not be given the effect of withdrawing from taxation what is in fact an earned premium by the mere device of calling it unearned, the court concluded that the Virginia statute gave to the amounts reserved all the attributes that pertain to unearned premiums, i.e., it withdrew them from the power of the company to use them for its general purposes and impressed them with a trust in favor of contract holders until the risks shall have been carried for the period that the statute prescribed. But there is no provision in Sections 101-136 and 101-137 of the Oregon Insurance Code comparable to the provisions of the Virginia statute.

Since the charges the instant taxpayer made for its services during the years 1942, 1943, 1944 and 1945 were properly accrued as income during each of those years, the fact that it was directed on January 12, 1946, undoubtedly to provide greater assurance with respect to its future solvency for the protection of its policyholders, would not, and could not alter its liability for federal income taxes if they were correctly determined otherwise on an annual basis. Accordingly, it is submitted that the total amount involved represents premiums earned (accrued) and not premiums unearned during the year 1945 under Section 204 (b) (5) of the Internal Revenue Code. Accordingly,

we maintain that the District Court erred in holding that the Commissioner of Internal Revenue improperly restored the amount of the disputed reserve to the taxpayer's taxable income for the year 1945.

3. Congress, in enacting Section 204 (b)(5) of the Internal Revenue Code, made no provision in the case of an insurance company, other than life or mutual, for the deduction of any reserve whatever. The deductions from gross income granted by Congress to insurance companies, other than life or mutual, by the Internal Revenue Code are listed in detail in Section 204 (c) (1) to (10), inclusive. There is no provision therein contained for the deduction by such companies of an insurance reserve of any kind.

This is particularly significant since in the preceding Section 201 of the Internal Revenue Code (26 U.S.C. 1946 ed., Sec. 201), pertaining to life insurance companies, as well as in the succeeding Section 207 of the Internal Revenue Code (26 U.S.C. 1946 ed., Sec. 207), pertaining to mutual insurance companies, other than life and marine, there are expressly set forth provisions for the deduction of reserve funds required by law in the case of those companies. The omission was deliberate. Prior to the enactment of the Revenue Act of 1921, all insurance companies were permitted to deduct from gross income "the net addition, if any, required by law to be made within the year to reserve

funds."[2] That deduction was eliminated by Congress, however, in the case of insurance companies, other than life or mutual, after December 31, 1921, by Section 234 (a) (10) of the Revenue Act of 1921, providing as follows:

> "SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * * * * *
>
> (10) In the case of insurance companies (other than life insurance companies), in addition to the above (unless otherwise allowed): (A) The net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and (B) The sums other than dividends paid within the taxable year on policy and annuity contracts. After December 31, 1921, this subdivision shall apply only to mutual insurance companies other than life insurance companies; * * *"

Nowhere in the Internal Revenue Code, as already stated, is there any provision for the deduction of any reserve in the case of companies of the type here in question. Accordingly, we maintain that the deduction claimed by the

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[2] Corporation Excise Tax Act of 1909, c. 6, 36 Stat. 11, 113, Section 38 (Second); Income Tax Act of 1913, c. 16, 38 Stat. 114, 172-173, Section IIG (b) (Second); Revenue Act of 1916, c. 463, 39 Stat. 756, 767-768, Section 12(a) (Second) (c); Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077-1079, Section 234(a)(10).

taxpayer should have been denied by the District Court, even though the amounts which it was required by the rule of the Insurance Commissioner of Oregon to segregate and maintain in the reserve for alleged unearned premiums were wholly set aside and taken away from the jurisdiction of its board of directors and were not available to it as surplus for the payment of dividends to its stockholders during that period. Whether this reserve required by rule of the Insurance Commissioner of Oregon purportedly as an "unearned premium" reserve might possibly be a valid reserve of another character under the Oregon statute is immaterial, because the taxpayer—an insurance company other than life or mutual—is not entitled to deduct any reserves in the computation of its taxable income. *American Title Co.* v. *Commissioner, supra; Pacific Employers Insurance Co.* v. *Commissioner,* 89 F. 2d 186 (C.A. 9th).

4. If, contrary to our argument above, it were held that the directive of the Insurance Commissioner of Oregon was valid, such a holding, we believe, would necessarily have to be based on an erroneous conclusion that the Oregon statute did not use the term "unearned premiums" in the well-established meaning of that term. But the conclusion, whether erroneous or not, that the term "unearned premiums" is not used in its ordinary sense in the Oregon statute would preclude a holding that the present taxpayer is entitled to any deduction or exclusion under the federal taxing statute which in Section 204 (b)(5) provides for

the exclusion from underwriting income of "unearned premiums", for it may not be controverted that the term "unearned premiums" is used in the federal statute in the ordinary sense in which that term is understood in the insurance industry and as such excludes premiums on title insurance, which are fully earned when policies are written.

Moreover, even if the assumption be made that some part of title insurance premiums may by directive of a state official be given all of the attributes of "unearned premiums", this does not mean, and cannot mean, that a reserve may be set up in one year for all policies theretofore written by the company, during its entire life or a portion thereof, and have that reserve treated as "unearned premiums" on the policies written during the year in which the reserve for the first time is established.

The federal taxing statutes are based, as is so well-known as to require no citation, on an annual system of tax accounting. Prior to the issuance on January 12, 1946, of the directive of the Insurance Commissioner of Oregon to the present taxpayer there was no ground whatsoever for contending that the premiums received by taxpayer for the writing of title policies were not fully earned when the policies were written. The risk was not a continuing one for a prescribed period of time, but was a single risk incurred at the time the policy was written and for which risk the premium was intended to compensate. No portion of the premiums re-

ceived was returnable to the contract holders *qua* premiums. The company had unfettered power to use those premiums for any of its general purposes and thus had full economic enjoyment of those amounts. Under no test, therefore, of the federal statute, as of the close of the taxable year 1945, could any portion of the premiums received or accrued in 1945 or any prior year be treated as unearned.

The requirement of the directive of January 12, 1946, issued by the Insurance Commissioner that taxpayer set up a reserve retroactively as of December 31, 1945, cannot change the federal tax consequences of events which had transpired prior thereto. Once the incidence of the federal tax has become fixed upon events which have actually transpired during the taxable year, the federal tax consequences of those events cannot thereafter be changed retroactively, for to do so would violate the principle of annual tax accounting to which we have adverted. Cf. *United States* v. *Lewis,* 340 U. S. 590.

Furthermore, the attempt by the taxpayer to reduce 1945 underwriting income by the entire amount of the reserve required by the directive of January 12, 1946, to be established as of December 31, 1945, and the holding of the court below sustaining that position of the taxpayer, constitute an unwarranted distortion of the underwriting income and tax liability of the taxpayer. That reserve, even if validly required and even though it might be given the

status of a reserve for unearned premiums, was not required to be established out of 1945 *income.* It was not a reserve established solely for holders of contracts written in 1945. It was a reserve for holders of all contracts, those written before 1945 as well as those written during 1945. It was in truth an arbitrary amount required to be set apart *from any appropriate funds* of the taxpayer, though in terms a percentage of the premiums received over the four-year period of 1942 to 1945, inclusive. The amount of the reserve could, and should, have been established out of the earned surplus of the company.

Respectfully submitted,

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July, 1951.

APPENDIX

Internal Revenue Code:

SEC. 204. INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.

(b) *Definition of Income, Etc.*—In the case of an insurance company subject to the tax imposed by this section—

(1) [as amended by Section 135 of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Gross income.*—"Gross income" means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, and (B) gain during the taxable year from the sale or other disposition of property, and (C) all other items constituting gross income under section 22; except that in the case of a mutual fire insurance company described in paragraph (1) of subsection (a) of this section, the amount of single deposit premiums paid to such company shall not be included in gross income;

(2) *Net income.*—"Net income" means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section;

* * * * *

(4) *Underwriting income.*—"Underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) [as amended by Section 164 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Premiums earned.*—"Premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year. For the purposes of this subsection, unearned premiums shall include life insurance reserves, as defined in section 201(c)(2), pertaining to the life, burial, or funeral insurance, or annuity business of an insurance company subject to the tax imposed by this section and not qualifying as a life insurance company under section 201(b);

* * * * *

(26 U.S.C. 1946 ed., Sec. 204.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.204-1. *Tax on Insurance Companies Other Than Life or Mutual and Mutual Marine Insurance Companies.*—All insurance companies (other than life or mutual or foreign insurance companies not carrying on an insurance business within the United States) and all mutual marine insurance companies are subject to the tax imposed by section 204. * * * The net income of insurance companies is defined in section 204 and differs from the net income of other corporations. * * * Since section 204 provides that the underwriting and

investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income and since the annual statement is rendered on the calendar year basis, the returns under section 204 shall be made on the basis of the calendar year and shall be on Form 1120. * * *

* * * * *

SEC. 29.204-2. *Gross Income of Insurance Companies Other Than Life or Mutual and Mutual Marine Insurance Companies.*—Gross income as defined in section 204(b) means the gross amount of income earned during the taxable year from interest, dividends, rents, and premium income, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, as well as the gain derived from the sale or other disposition of property, and all other items constituting gross income under section 22. * * * The underwriting and investment exhibit is presumed clearly to reflect the true net income of the company, and in so far as it is not inconsistent with the provisions of the Internal Revenue Code will be recognized and used as a basis for that purpose. * * * In computing "premiums earned on insurance contracts during the taxable year" the amount of the unearned premiums shall include (1) life insurance reserves as defined in section 201(c)(2) and section 29.201-4 pertaining to the life, burial, or funeral insurance, or annuity business of an insurance company subject to the tax imposed by section 204 and not qualifying as a life insurance company under section 201(b), and (2) liability for return premiums under a rate credit or retrospective rating plan based on experience, such as the "War Department Insurance Rating Plan," and

which return premiums are therefore not earned premiums. * * *

7 Oregon Compiled Laws Annotated (1940)

SEC. 101-105.—*General powers and duties of commissioner.* (1) The insurance commissioner shall have and exercise the power to enforce all the laws of the state relating to insurance, and it shall be his duty to enforce all the provisions of such laws for the public good. He shall issue such department rulings, instructions and orders as he may deem necessary to secure the enforcement of the provisions of this act, but nothing contained in this act shall be construed to prevent any company or persons affected by any order or action of the insurance commissioner from testing the validity of same in any court of competent jurisdiction.

* * * * *

(3) [Furnishing of form for financial statement.] Every insurance company, doing business in the state, shall file with the commissioner, on or before March 1st of each year, a financial statement for the year ending December 31st immediately preceding on [a] form furnished by the commissioner, which shall conform as nearly as may be to the form of statement from time to time adopted by the national convention of insurance commissioners, and containing such detailed exhibit of the condition and transactions of the company as the commissioner, in such form and otherwise shall reasonably prescribe. Such statement shall be verified by the oaths of the president and secretary of the company, or in their absence by two other principal officers. The statement of a company of a foreign country shall embrace only its condition and transactions in the United States, and shall be verified by the oath of its

resident manager or principal representative in the United States. In the discretion of the commissioner, a penalty of ten dollars per day shall attach for delinquency in filing such statement.

* * * * *

SEC. 101-136. (*Examination into affairs of company or persons in insurance business: Appointment of examiners: Duty to produce books and papers and to facilitate examination: Report of examiners: Hearing: Inspection and publication of report: Expenses of examination.*) The insurance commissioner shall, whenever he deems it advisable in the interest of policyholders or for the public good, examine into the affairs of any insurance company, agency, corporation, partnership, person or persons engaged in or proposing to engage in the insurance business of this state, and into the affairs of any company organized under any law of this state or having an office or representative in this state, which company is engaged in or is claiming or advertising that it is engaged in organizing or receiving subscriptions for or disposing of stock of, or in any manner aiding or taking part in the formation or business of an insurance company or companies, or which is holding capital stock of one or more insurance companies for the purpose of controlling the management thereof as voting trustee or otherwise. * * * It shall be the duty of the insurance commissioner to examine every domestic insurance company at least once in three years.

SEC. 101-137. *Examination: Reserve: Liability: (Formulating or adopting rules).* In ascertaining the condition of an insurance company under the provisions of this act, or in any examination made by the insurance commissioner, his deputy, or examiner, he shall allow

as assets only such investments, cash and accounts as are authorized by the laws of this state at the date of the examination, or under the existing laws of the state or country under which such company is organized and which investment he may approve or reject, but unpaid premiums on policies written within three months shall be admitted as available resources. In ascertaining his liabilities, unless otherwise provided in this act, there shall be charged the capital stock, all outstanding claims, a sum equal to the total unearned premiums on the policies in force computed on a pro rata basis, and such an amount as may be found necessary as a reserve to provide for the future payment of deferred and undetermined claims for losses and promised benefits. In determining the amount of such reserve or unearned premium liability, the insurance commissioner, his deputy or examiner may formulate such rules as he may deem proper and consistent with law or he may adopt such rules as are used in other states or approved by the national convention of insurance commissioners.

SEC. 101-138. *Revocation of certificate or license: Court review.* (1) If the commissioner shall find upon examination or other evidence that any insurance company is in an unsound condition, or that it has failed to comply with the law or with the provisions of its charter or articles of incorporation or association, or that its condition is such as to render its proceedings hazardous to the public or to its policy-holders, or that its actual assets exclusive of its capital are less than its liabilities, or if its trustees, directors, officers, or agents refuse to submit to examination or to produce at the office where the same are kept, its books, records, accounts, and papers in its or their possession or control relating to its business or affairs, for examination and inspection

of the commissioner, his deputy or examiner, when required, or shall refuse to perform any legal obligation relative to such examination, the commissioner shall revoke or suspend all certificates of authority and licenses granted to such insurance company, its officers or agents, and shall cause notice thereof to be given to such company and to each agent of such company in this state and no new business shall thereafter be done by such company or for such company by its agents, in this state, while such revocation, suspension, or disability continues, nor until its authority to do business is restored by the commissioner.

*   *   *   *   *

No. 12894

United States
COURT OF APPEALS
for the Ninth Circuit

UNITED STATES OF AMERICA,
Appellant,

v.

PACIFIC ABSTRACT TITLE CO.,
a Corporation,
Appellee.

On Appeal from the United States District Court
for the District of Oregon

BRIEF FOR THE APPELLEE

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STEVENS-NESS LAW PUB. CO., PORTLAND 7-51

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STATEMENT

Supplementing the statement made by the Appellant, Appellee wishes to add certain other facts. Pursuant to Sections 101-1501 and 101-1502, O.C.L.A., appellee deposited with the Treasurer of the State of Oregon many years ago securities in the value of $100,000.00. This deposit is a solvency deposit and is wholly unrelated to the reserve now in question (R. 28).

In December, 1945, the Insurance Commissioner of the State of Oregon promulgated a rule ordering title insurance companies to maintain an unearned premium reserve beginning with the calendar year 1942 amounting to 3% of the total gross fees and premiums received. A written copy of this rule was mailed to the Appellee on January 12, 1946, and is as follows:

> "1. The Pacific Abstract Title Company shall establish, segregate and maintain an unearned premium or reinsurance reserve as hereinafter provided, which shall at all times and for all purposes be deemed and shall constitute unearned portions of the premiums and shall be charged as a reserve liability of your corporation in your statements; such reserve shall be cumulative and shall be established and shall consist of the following:
>
> "(a) As at December 31, 1945 or within a period of three years thereafter an amount equal to 3% of the total gross fees and premiums received or to be received on account of policies issued during the four calendar years—1942, 1943, 1944 and 1945; and
>
> "(b) Monthly at the close of each month beginning January, 1946, 3% of the total gross fees and premiums received or to be received on account of policies written during the preceding calendar month;
>
> "(c) After the expiration of 180 months from January 1, 1942, that portion of the unearned premium or reinsurance reserve established more than 180 months prior shall be released and shall no longer constitute part of the unearned premium or reinsurance reserve and may be used for any corporate purposes.
>
> "2. Hereafter the Pacific Abstract Title Company shall segregate and maintain a "Title Loss Reserve" at least equal to the aggregate estimated

amount due or to become due on account of all unpaid losses and claims upon title insurance policies of which the company has received notice but not less than the aggregate of title losses incurred during the immediately preceding 56 months.

"3. Hereafter the Pacific Title Company shall not issue a policy of title insurance for a single transaction, the face amount of which shall exceed an amount which is five times the capital and surplus of your company; but nothing herein shall prevent the Pacific Abstract Title Company from assuming the risk on a single policy jointly with another title insurance company or companies in excess of five times the Pacific Abstract Title Company's capital and surplus, provided that the total amount of such insurance shall not exceed five times the total combined capital and surplus of all such companies liable under such insurance; and provided that each such company shall not assume more than its proportionate share of the total amount at risk in accordance with the above defined maximum retention limit." (R 26, 27) (Plaintiff's Exhibit 1)

This rule applied to all Title Insurance Companies in the State of Oregon. Appellee's books and affairs were examined by the Insurance Commissioner of the State of Oregon in the year 1945 and at the conclusion of this examination Appellee was directed to set up an unearned premium reserve as of December 31, 1945 for the years 1942, 1943, 1944 and 1945 (R 26, 27). On December 26, 1945, this order was made and a letter addressed to the Title and Trust Company (R 27, Plaintiff's Pretrial Exhibit 2).

In December, 1945, officers of the Title and Trust Company exhibited to officers of Appellee the written

rule received by the Title and Trust Company from the Insurance Commissioner.

In December, 1945, Appellee had read the full text of the rule and had actual notice that the rule had been promulgated (R 27).

With this knowledge, Appellee set up on its books a reserve as called for in the order as of December 31, 1945.

POINTS AND AUTHORITIES

I.

The reserve consisted of unearned premiums as that term is used in Section 204 (b) (5) of the Internal Revenue Code.

American Title Co. v. Comm., 76 Fed. 2d 332.

City Title Ins. Co. v. Comm., 152 Fed. 2d 859.

Morgan vs. Comm. of Int. Rev., 309 U.S. 78, 80, 626; 60 S. Ct. 424, 426; 84 L. Ed. 585, 1035.

Section 204 (b (5) of the Internal Revenue Code.

Early v. Lawyers Title Insurance Corp., 132 Fed. 2d 42.

New Hampshire Fire Insurance Co., 2 T. C. 708 Affirmed by Circuit Court of Appeals, 1st Circuit in Comm. of Int. Rev. v. New Hampshire Fire Insurance Co., 146 Fed. 2d 697.

Mass. Protective Assoc. v. U. S., 114 Fed. 2d 304.

Commissioner v. Dallas Title & Guaranty Co., 119 Fed. 2d 211.

Maryland Casualty Co. v. U. S., 251 U.S. 342; 64 L. Ed. 297.

Fidelity & Deposit Co. of Maryland v. U.S.C.C.H. Standard Federal Tax Reporter; 1950 Vol. 5, p. 12, 119 Par. 9106 Affirmed in U.S. v. Fidelity & Deposit Co., 177 Fed. 2d 753.

Solomon S. Huebner Property Ins., Ch. 14, pp. 153, 154.

Title & Trust Co. v. Commissioner, 15 T.C. 510.

ARGUMENT

Appellant admits that companies that insure land titles for a consideration are taxable as insurance companies. (Appellant's Br. 9)

Special statutory provisions have been made with respect to insurance companies other than Life and Mutual. The applicable provisions of Section 204 of the Internal Revenue Code are as follows:

> (b) DEFINITION OF INCOME, ETC. In the case of an insurance company subject to the tax imposed by this section:
>
> (1) GROSS INCOME: "Gross Income" means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, and (B) gain during the taxable year from the sale or other disposition of property, and (C) all other items constituting gross income under Section 22; except that in the case of a mutual fire insurance company described in paragraph (1) of subsection (a) of this section, the amount of single deposit premiums paid to such company shall not be included in gross income;

(4) UNDERWRITING INCOME: "Underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) PREMIUMS EARNED: "Premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year.

For the purposes of this subsection, unearned premiums shall include life insurance reserves, as defined in section 201 (3) (2), pertaining to the life burial, or funeral insurance, or annuity business of an insurance company subject to the tax imposed by this section and not qualifying as a life insurance company under section 201 (b).

The meaning of taxable income, unearned premiums and insurance reserves as applied to insurance companies has been before the courts in many cases.

In *Maryland Casualty Co. vs. U. S.,* 251 U.S. 342, 64 L. Ed. 297, the Court defines reserves to mean:

"A sum of money variously computed or estimated which, with accretions from interest, is set aside 'reserved' as a fund with which to mature or liquidate either by payment or reinsurance future unaccrued and contingent claims; claims accrued but contingent and indefinite as to time or amount of payment. The term includes unearned premium reserve to meet future liabilities on policies".

Solomon S. Huebner, in his work Property Insurance, Chapter 14, Pages 153-154, quoted in respondent's brief, states:

> "This unearned portion of the premium constitutes a reserve. It must be regarded as a sum held in trust by the company for its policyholders. . . . The reinsurance reserve may thus be defined as an 'unearned premium' . . . "

In *Commissioner vs. Dallas Title & Guaranty Company* (CCA 5), 119 Fed. 2d 211, the Court states:

> "It is not impossible for the premium paid a title insurance company to be unearned."

In *Massachussetts Protective Association vs. U. S.*, 114 Fed. 2d 304, quoted with approval in *Early vs. Lawyers Title Insurance Corp.*, 132 Fed. 2d 42, the Court states that a reserve for noncancellable health and accident policies, whether returnable to the insured or not, was not available for the use of the general purposes of the plaintiff but was held as a liability to provide for the payment or reinsurance of specific contingent insurance liabilities and as long as these reserve funds were not to be used for the general purposes of the company, they were not earned premiums within the meaning of Congress and not includable as gross income. The Court stated:

> "The test is not whether the part of the premium set aside in the reserve for non-cancellable health and accident insurance 'belongs' to the company in the event of cancellation or lapsing of the policies, but whether that amount is such a part of the company's gross income as Congress considered should be treated as net income for the purposes of taxa-

> tion. McCoach vs. Insurance Company of North America, supra. We hold that it is not."

In the Massachusetts case, the Commissioner contended that the reserve could not be unearned premiums because if the policy was cancelled, the policyholder received no surrender value and the petitioner kept the excess reserve accumulated. The Court held that nevertheless, the reserves did constitute unearned premiums.

The Court pointed out that the surrender value of life insurance is never the full value of the reserve as a surrender charge is deducted. Upon the cancellation of a fire insurance policy, the total pro-rata share is not repaid to the policyholder as a monthly short-rate is deducted. Therefore, "unearned premium" cannot be tested by what the company must return on cancellation.

In *Early vs. Lawyers Title Insurance Corp.* (supra) (Appendix infra), the appellant contended that earned premiums paid for title insurance are earned when received and that the effect of the statute of Virginia, which required the title company to set up a reserve, was to provide a mere solvency reserve which the company was not entitled to treat as unearned premiums.

The Court, in answering this contention, cited the *Commissioner vs. Dallas Co.* (supra), case with approval and stated:

> "Unquestionably, the premium collected for title insurance is not all clear profit or income to the company immediately upon its receipt. As a matter of fact, there is a time element as well as the element of contract to be considered in connection with the risk assumed in this type of insurance as well as in other

> types; and if any portion of the premiums, in consideration of the time element, is given, either by law or contract, the status ordinarily accorded an unearned premium in insurance law during any portion of the period for which the risk is operative, there is no reason why it should not be treated as an 'unearned' premium within the meaning of the taxing statute during this period. We think that the Virginia statute has this effect."

The Insurance Commissioner is not attempting by "legislative fiat" or order to convert earned premiums into unearned premiums. As stated in *Early vs. Lawyers Title Insurance Corp.,* 132 Fed. 2d 42:

> "The sums thus set aside 'at all times and for all purposes' are, by mandate of the statute, to 'constitute unearned portions of the original premiums'. This means that they are not available to the company for its ordinary purposes, until the times limited in the statute have expired, but, until then, are held in trust for the benefit of the contract holders. If the company should in the meantime become insolvent, they would be available as unearned premiums for reinsurance of the contracts, or if not used for that purpose would belong to the contract holders". Citing cases.

And again:

> "We agree that a statute of the state could not be given the effect of withdrawing from taxation under the Revenue Act what was in fact an earned premium by the mere device of calling it unearned; but the Virginia statute does more than this. It gives to the portions of the premiums which it requires to be placed in the reserve all of the attributes that pertain to unearned premiums, i.e., it withdraws them from the power of the company to use them for its general purposes and impresses them with a trust in favor of contract holders until the risk shall have been carried

> for the period that the statute prescribes. . . . Until then, the company cannot be truly said to have earned the portion of the premium which the law requires it to reserve and hold in trust during this crucial period of risk".

It was also contended in the Early case that the term "unearned premiums" in the taxing statute must be given its ordinary meaning. Again the Court said:

> "This is undoubtedly correct; but so also must the term as used in statute of Virginia, and when given that meaning there its effect is to impress upon the portions of the premiums reserved the characteristics which bring them within the meaning of the term as used in the taxing statute."

State law creates legal interests and rights. The federal revenue acts designate what interests or rights so created shall be taxed. *Morgan vs. Commissioner of Internal Revenue,* 309 U.S. 78, 80, 626; 60 S. Ct. 424, 426; 84 L. Ed. 585, 1035.

Respondent contends that Congress in enacting Section 204 (b) (5), of the Internal Revenue Code made no provision in the case of an insurance company, other than life or mutual, for the deduction of any reserve whatever (page 19, Respondent's Brief). This same argument was advanced in *Massachusetts Protective Association vs. U. S.* (supra), where it was argued that the reserve was not to be added to the unearned premium in computing gross income because Congress, in 1926 made no provision for the deduction from the gross premiums of insurance companies other than life or mutual of the net addition to the reserve funds required by law which had been allowed all insurance companies prior to 1921.

The Court, in answer to this argument, stated that no departure had been made by Congress from the previous system of taxing only earned premiums of insurance companies. The Court stated that deduction of net addition to reserve funds required by law is not prevented if the addition represents unearned premiums.

The case of *Early vs. Lawyers Title Insurance Corp.* (supra) is a leading case with reference to reserves set up by title insurance companies. All the contentions now presented by the Appellant in this case were presented in the Early case. In the case before the Court, the rule of the Oregon Insurance Commissioner had the same effect as the Virginia statute in the Early case. The Commissioner in said rule recognized the time element as well as the element of contract in connection with the risk assumed.

That portion of the premiums, in consideration of the time element of the risk, which the Insurance Commissioner's rule gave the status ordinarily accorded an unearned premium in insurance law for the period designated in the rule should be treated as unearned premiums within the meaning of the taxing statute during this period.

A portion of the income of the Appellee was placed in reserve and frozen for a period of time and was not available for general corporate purposes. Eventually, after the expiration of the 15-year period referred to in the Insurance Commissioner's rule, the unused reserves will become available to the company as earnings without any restriction as to their use and will then become part of

the income of the corporation for income tax purposes.

The premium is not wholly earned at the time it is paid even though no part of the premium is returnable to the policyholder upon cancellation. There is a liability on the title insurance policy which gradually diminishes during the passage of time by reason of the statute of limitations and other rules of law which cure defects in the title. The test of an unearned premium is whether or not a portion of the premium is withdrawn from the power of the company to use for its general purposes until the time limited by law has expired. If the premium is not permanently withdrawn, then the portion held in the reserve is an unearned premium and is not taxable as income until it is available to the company for general corporate purposes.

The rule of the Insurance Commissioner of Oregon requiring an unearned premium reserve does not freeze these funds permanently. After the expiration of the 15-year period, if the unearned premiums have not been used for the benefit of the policyholders for whom the premiums were set aside, they then become earned and become taxable income to the company. In the meantime, however, they are held as a trust fund for the benefit of the policyholders until such times as they become released by the order of the Insurance Commissioner. This fund has all the attributes of an unearned premium reserve allowable under Section 204 of the Internal Revenue Code, and, therefore, it is an unearned premium reserve.

In *American Title Company vs. Commissioner,* 76 Fed. 2d 332, reserves were set up by the company for the protection of policyholders as required by the laws of Pennsylvania and this reserve fund was deducted from gross income on the federal tax return of the company. The Court held that the reserves were not deductible. Under the Pennsylvania statute, the reserves were not to be returned until the last outstanding policy of the company had expired. There was a permanent freezing of the funds and for this reason the Court held this to be an insolvency fund and not an unearned premium reserve.

In the case of *City Title Insurance Co. vs. Commissioner,* 152 Fed. 2d 859, a similar ruling was made with respect to unearned premiums set up under the New York statute. The New York statute did not provide for the return of the reserves to the insurance company. Whether the reserves are to be returned to the company or permanently set aside is the determining factor in this case. (In the opinion of the Court, reference was made to the *American Title Co.* case, and the case of *Early vs. Lawyers Title Insurance Co.,* 132 Fed. 2d 42, infra.) In the *City Title Insurance Company* case, the deduction of reserves was claimed for the years 1938 to 1941 inclusive. From the Court's decision, it is apparent that the New York statute was amended in 1945 to apply to unearned premium reserves and reinsurance reserves to be held for a limited time of 180 months. The Court did not attempt to decide the effect of the amendment as the taxes involved were all prior to the time of the amendment. However, no further question has been

raised by the Commissioner as to deductions for reserves under the amended New York statute, which amended New York statute is similar to the Virginia statute construed in the Early case, supra.

It would seem that the Court would take judicial knowledge of the fact that the population in the West has greatly increased in the last nine years, and also of the fact that there has been a very great increase in the value of real property in the same period of time. Inasmuch as title insurance companies insure the full value of the property, this increase in values has increased their liabilities enormously. For these reasons, the Insurance Commissioner of the State of Oregon evidently deemed it advisable to promulgate this rule in 1945 setting up an unearned premium reserve for the benefit and protection of title insurance policyholders and for the public good.

I wish to point out to the Court that this is not an insolvency reserve because, as stated before, Appellee has already deposited many years ago, securities in the value of $100,000.00 as a solvency reserve. The Commissioner, in the exercise of his administrative discretion, evidently considered it necessary to set up this reserve for the protection of the policyholders themselves.

POINTS AND AUTHORITIES

II.

The delegation of the power to determine the amount of the unearned premiums on a pro rata basis and the amount necessary as a reserve to provide for the future payment of deferred and undetermined claims is a valid delegation of legislative power and the order of the Insurance Commissioner of Oregon fixing the amount of the unearned premium reserve to be reserved by Appellee is within the limits of the power so delegated.

Section 101-105, O.C.L.A., Subdiv. (1), (2).

Section 101-107, O.C.L.A., Subdiv. (7).

Section 101-136, O.C.L.A.

Section 101-137, O.C.L.A.

Field vs. Clark, 143 U.S. 649.

Hampton & Co. vs. U. S., 276 U.S. 394, 72 L. Ed. 624, 48 S. Ct. Rep. 348.

U. S. vs. Rock Royal Cooperative, Inc., 307 U.S. 533, 83 L. Ed. 1446.

Maryland Casualty Co. vs. U. S., 251 U.S. 342, 64 L. Ed. 297.

State vs. Terwilliger, 141 Or. 372, 11 Pac. 2d 552, 16 Pac. 2d 651.

Savage vs. Martin, 161 Or. 660, 91 Pac. 2d 273.

White vs. Mears, 44 Or. 215, 74 Pac. 931.

State vs. Briggs, 45 Or. 366, 77 Pac. 750.

Fidelity & Deposit Company of Maryland vs. U. S. (Unreported, but may be found in C.C.H. Standard Federal Tax Reporter, Vol. 5, p. 12, 119 Par. 9106.)

Affirmed U. S. vs. Fidelity & Deposit Co., 177 Fed. 2d 805, Rehearing denied 178 Fed. 2d 753.

New Hampshire Fire Insurance Co., Affirmed, Commissioner of Internal Revenue vs. New Hampshire Fire Insurance Company, 146 Fed. 2d 697.

Cancilla vs. Gehlhar, 145 Or. 184, 27 Pac. 2d 179.

11 Amer. Jur. 945, Sections 232 through 237.

11 Amer. Jur. 955, Sections 240 and 241.

The statutes of Oregon defining the duties and powers of the Insurance Commissioner of Oregon are set out in full in the Appendix.

Pursuant to these statutes the Insurance Commissioner of Oregon made an extensive examination into the business conditions of the Appellee. The order of the Insurance Commissioner directing that an adequate unearned premium reserve be provided is the result of his study and analysis of the statutes of the various states, the trend and experience of the Appellee, the premium volume, and the size and types of risks underwritten. The reserve which he ordered to be set up was the result of an actuarial study made by the Insurance Commissioner of the State of Oregon. This is not a permanent reserve, but is only to be held for a period of 180 months and thereafter will become freed again for general corporate purposes.

In the evolution of law, it has been determined that certain powers and duties may be delegated by the legislative body to an executive officer or administrative agency, including the right to make such rules and reg-

ulations as may be necessary to carry out the primary general laws enacted by the legislature. 11 Amer. Jur. 945, Section 232 through Section 237; 11 Amer. Jur. 955, Section 240 and Section 241.

The Appellant contends that the insurance laws of Oregon contain an improper delegation of legislative power to an administrative official and that the directive of the Oregon Insurance Commissioner transcended the power which the legislature delegated to him (Appellant's Br. 18, 20).

Under the authorities in Oregon and in the United States Courts, we believe the Appellant is in error in its contentions. In *U. S. vs. Rock Royal Cooperative, Inc.,* 307 U.S. 533, the act delegating authority to the Secretary of Agriculture to establish marketing areas was held valid. The Court laid down two tests: (1) does the act state the purpose which Congress seeks to establish; and (2) does the act state standards of sufficient exactness to enable those affected to understand the limits. It is submitted that the insurance statutes of the State of Oregon meet these tests and the delegation of authority to the Insurance Commissioner of Oregon is valid and constitutional. The rule of the Insurance Commissioner is reasonable and a valid exercise of this rule making authority.

O.C.L.A., Section 101-105 (1) provides that the Insurance Commissioner shall issue such department rulings, constructions and orders as he may deem necessary to secure the enforcement of the provisions of the Act. It is further provided that the Insurance Commissioner

may revoke the certificate of authority of an insurance company for failing to comply with the laws of the state and regulations of the Insurance Department (O.C.L.A. Sec. 101-107 (7). This statute further provides for examination of insurance companies to ascertain the condition of such companies and states:

> "In determining the amount of such reserve or unearned premium liability, the Insurance Commissioner, his deputy or examiner, may formulate such rules as he may deem proper and consistent with law, or he may adopt such rules as are used in other states and approved by the National Convention of Insurance Commissioners." (O.C.L.A. Sec. 101-136)

O.C.L.A., Sec. 101-137 delegates to the Insurance Commissioner the power to determine a formula upon which to calculate the portion of the premiums of insurance companies which is unearned and which is to be set aside as a reserve to provide for the future payment of deferred and undetermined claims for losses and promised benefits.

The statutes of Oregon, therefore, provide that the Insurance Commissioner shall set up an unearned premium reserve and the statutes further provide that the Insurance Commissioner shall determine the amount of such reserve in the exercise of his administrative duties after examination of the companies involved. Experience has proven that in the exercise of the functions of government, certain determinations within the general framework of a law must be delegated to an administrative agency which makes the necessary rules and regulations after and as the facts are determined.

In *Maryland Casualty Co. vs. U. S.*, 251 U.S. 342, 64 L. Ed. 297, the Court held that reserves required by rules and regulations of state insurance departments promulgated in the exercise of an appropriate power conferred by statute were deductible. The Court states:

> "A regulation by a department of government addressed to and reasonably adopted to the enforcement of an act of Congress, the administration of which is confined to such department, has the force and effect of law if it be not in conflict with express statutory provision. (citing cases) The law is not different with respect to the rules and regulations of a department of a state government."

In *Cancilla vs. Gehlhar,* 145 Or. 185, the Court states:

> "A legislature in enacting a law complete in itself, designed to accomplish the regulation of particular matters falling within its jurisdiction, may expressly authorize an administrative commission within definite valid limits to provide rules and regulations for the complete operation and enforcement of the law within its expressed general purpose." (Citing cases)

In the case of *Savage vs. Martin,* 161 Or. 660, the Court states:

> "The legislature can not delegate its power to make a law, but it can make a law to delegate a power to determine some fact or state of things upon which the law makes, or intends to make, its own action depend. . . . There are many things upon which wise and useful legislation must depend, which cannot be known to the law making power, and must, therefore, be a subject of inquiry and determination outside of the halls of legislation."

This is just what the laws of Oregon do provide—that the Insurance Commissioner shall set up for insurance companies an adequate reserve covering unearned premiums computed on a pro rata basis and in such an amount as may be found necessary to provide for the future payment of deferred and undetermined claims for losses and promised benefits. The Legislature further directed the Commissioner to set aside such an amount as may be found necessary as a reserve to provide for the future payment of deferred and undetermined claims and authorized the Commissioner to formulate the necessary rules for determining the amount of such reserve. The Legislature delegated to the Insurance Commissioner the power to investigate the condition and affairs of each insurance company in order to fix as a liability a sum equal to the total unearned premiums and the Legislature authorized the Commissioner to formulate the necessary rules for determining the amount of such unearned premium liability. In other words, all that was delegated to him was the delegation of power to determine the facts upon which to base his action. It is quite apparent the Insurance Commissioner of Oregon took into consideration the fact that title insurance companies in this area were assuming liabilities far in excess of those which had been assumed in previous years and the fact that it was necessary that said companies carry a reserve in addition to the solvency deposit to cover these increase liabilities under the title insurance policies issued in the last several years. Additional reserves were necessary to protect the policyholders. The Insurance Commissioner apparently with wisdom and foresight

felt that the growth of the community and extent of liability on title insurance policies would increase rather than decrease, having in mind that all property values in the country had greatly increased, and particularly so in the Pacific Northwest. Title insurance policies are premised upon the full value of the property.

From the various cases cited, it can plainly be seen that the Insurance Commissioner did not exceed the power conferred upon him by the Legislature and in his directive the words "unearned premiums" are used in their ordinary sense as stated in the Early case, supra. The term "unearned premiums" used in the Virginia statute was used in its ordinary sense and the same is true in the rule promulgated by the Oregon Insurance Commissioner.

The Appellant argues that the power to determine the amount of the unearned premium reserve delegated to the Insurance Commissioner is an unconstitutional delegation of legislative power (Appellant's Br. 22).

The Appellant also argues that the Insurance Commissioner, in setting up the amount of the unearned premium reserve, acted outside and beyond the power delegated by the Legislature (Appellant's Br. 18, 20).

These arguments are based on Appellant's premise that there is no such thing as "unearned premiums" in the title insurance business because the policyholder has no claim against the company for the return of any portion of his premium (Appellant's Br. 15).

But the Courts hold that the test of an unearned premium is not whether the policyholder is entitled to

the return of a portion of the premium, but whether a portion of the premium is withdrawn from the power of the Company to use for its general purposes until the time limited by law has expired and until then is impressed with a trust for the benefit of the policyholder.

Therefore, Appellant's entire argument is based on a fallacious premise and the rule of the Insurance Commissioner is a valid exercise of the power delegated to him by the Legislature. After investigation the Commissioner determined the amount of the reserve necessary. This determination is a valid administrative act and the delegation of the power to make an investigation and to so determine is a valid delegation of power.

POINTS AND AUTHORITIES
III.

The reserve was properly excluded from taxable income and accrued as a liability of Appellee in 1945.

Early vs. Lawyers Title Ins. Corporation, 132 Fed. 2d 42.

U. S. vs. Anderson, 46 Supr. Ct. Rep. 131.

Lucas vs. American Code Co., 280 U.S. 445, 50 S. Ct. 202, 74 L. Ed. 538, 67 A.L.R. 1010.

Lucas vs. Ox Fibre Brush Co., 281 U.S. 115, 50 S. Ct. 273, 74 L. Ed. 733.

U. S. vs. Anderson, 269 U.S. 422.

American National Co. vs. U. S., 274 U.S. 99, 47 S. Ct. Rep. 520, 71 L. Ed. 946.

Spring City Foundry Company vs. Commissioner, 292 U.S. 182, 78 L. Ed. 1200.

Security Flour Mills Company vs. Commissioner, 321 U.S. 281, 64 S. Ct. 596, 88 L. Ed. 725.

Commissioner vs. Blaine, Mackay, Lee Co., (CCA 3), 141 Fed. 2d 201.

Central Trust Co. vs. Burnet (CCA-DC), 45 Fed. 2d 992.

The Appellant contends that there could be no accrual of any funds for previous years for the reason that the premium had been determined and no unearned premium had been set aside. We submit to the Court that this argument is not sound. The Appellee, pursuant to the order of the Insurance Commissioner, deducted a sum of money from its surplus and set it up as a reserve as of December 31, 1945. This was based upon a percentage of premiums received in previous years, but the funds were taken out of the funds of the company in 1945. This question was decided in *Early vs. Lawyers Title Ins. Corp.*, 132 Fed. 2d 42, where the Court at page 46 says:

> "We were disturbed upon the argument because the deduction of the reserve resulted in what seemed to be a distortion of the income of the company for the year 1936. Further consideration convinces us that the position of the company with respect thereto is correct. Under the language of the Revenue Act there is no authority for adding to premiums received during 1936 any part of the reserve held at the end of the preceding year, as none of this reserve had been given the status of unearned premiums. The passage of the Virginia statute unquestionably resulted in funds to the amount of the reserve at the end of the year being withdrawn from the unfettered control of the company and being held in trust for the benefit of contract holders; and the practical affect of this was to decrease by such

> amount the income of the year available for ordinary purposes. Furthermore, income tax had already been paid on the amount held in reserve prior to the passage of the statute; and, to add any part of this amount to the premiums collected in the year 1936, for the purpose of determining underwriting income for that year, would result in its being taxed twice. The amount deducted as unearned premiums does not, of course, escape taxation, since it is subjected to tax as it is released from the reserve pursuant to the provisions of the statute.

In that case, the same situation existed as in this case. The Court decided that the passage of the Virginia statute resulted in funds to the amount of the reserve at the end of the year being withdrawn from the unfettered control of the company and beind held in trust for the benefit of contract holders; and the practical effect of this was to decrease by such amount the income of the year available for ordinary purposes. The rule of the Insurance Commissioner of Oregon has the same effect as the Virginia statute.

Under the income tax statutes where a taxpayer is on the accrual basis, items of income are reported in full in the year in which they are earned. On the other hand deductions or liabilities ordinarily cannot be taken or deducted until they become fixed or certain, and sometimes by an identifiable event. In this case, the liability which resulted in the reserve of income for unearned premiums arose with the order of the Insurance Commissioner of Oregon as set forth in letter dated December 26, 1945 to the Title and Trust Company, and it was at that time that the liability became fixed and the plaintiff knew that a reserve would have to be set up. A case

somewhat similar in its holding is the case of *U. S. vs. Anderson,* 46 Supr. Ct. Rep. 131, wherein all of the facts as to a munition tax was known in one year but the tax was not paid until the following year. The Court, however, held that the accrual should have been made in a prior year. The Court stated:

> "In a technical sense, a tax does not accrue until it has been assessed and becomes due, but it is also true that in advance of the assessment of a tax, all the events may accrue which fix the amount of the tax and fix the amount of the liability of the taxpayer to pay it. In this respect for the purposes of accounting and of ascertaining a true income for a given accounting period, the munition tax here in question did not stand on any different footing than other accrued expenses appearing on appellee's books."

In *Lucas vs. American Code Co.,* 280 U.S. 445, 50 S. Ct. 202, 74 L. Ed. 538, 67 A.L.R. 1010, the United States Supreme Court held that damages for breach of a contract of employment recovered against a taxpayer accounting on the accrual basis are not deductible in the year in which the breach occurred where the amount was not determined or paid until later and which was contested and the amount was wholly unpredictable until the litigation was ultimately brought to a close.

Following this case the Supreme Court decided the case of *Lucas vs. Ox Fibre Brush Co.,* 281 U.S. 115, 50 S. Ct. 273, 74 L. Ed. 733, wherein a corporation was granted extra compensation to its officers for services performed in prior years. The United States Supreme Court held that even though this payment was for services in prior years, it was a proper deduction in determin-

ing the taxable income of the corporation for the year in which the grant was made even though the books of the corporation were kept on an accrual basis. In its opinion, the Court referred to the sections of the income tax statute with respect to computing net income and stated as follows:

> "This section relates to the method of accounting; the commissioner may make the computation on a basis that does clearly reflect the income, if the method employed by the taxpayer does not. But this section does not justify the commissioner in allocating to previous years a reasonable allowance as compensation for services actually rendered, when the compensation was properly paid during the taxable year and the obligation to pay was incurred during that year and not previously. In the present instance, the expense could not be attributed to earlier years, for it was neither paid nor incurred in those years. There was no earlier accrual of liability. It was deductible in the year 1920 or not at all. Being deductible as a reasonable payment, there was no authority vested in the commissioner to disregard the actual transaction and to readjust the income on another basis which did not respond to the facts."

Deductions should be accrued when all events have occurred which fix the liability, even though the amount be then uncertain. The accrual system wholly disregards due dates. Neither is it necessary that the amount of an incurred liability be accurately ascertained in order to "accrue" it. *U. S. vs. Anderson,* 269 U.S. 422. *American National Co. vs. U. S.,* 274 U.S. 99, 47 S. Ct. Rep. 520, 71 L. Ed. 946.

The accrual of a reserve to cover liability for unearned premiums is in the general category of other

deductions and not entirely unlike the reasoning which is applied to debts ascertained to be worthless and charged off. The right to take a deduction only exists in a year in which it becomes fixed or determined as pointed out by the Supreme Court in *Spring City Foundry Company vs. Commissioner,* 292 U.S. 182, 78 L. Ed. 1200. This principle was further enunciated by the Supreme Court in *Security Flour Mills Company vs. Commissioner,* 321 U.S. 281, 64 S. Ct. 596, 88 L. Ed. 725, where the Court said:

> "This legal principle has often been stated and applied. The uniform result has been denial both to Government and to the taxpayer of the privilege of allocating income or outgo to a year other than the year of actual receipt or payment, or, applying the accrual basis, the year in which the right to receive, or the obligation to pay, has become final and definite in amount."

In the case of *Commissioner vs. Blaine, Mackay, Lee Co.* (CCA 3), 141 Fed. 2d 201, the Court said:

> "Under the accrual system (here in use) income is accruable in the year in which the taxpayer's right thereto becomes fixed and definite, even though it may not be actually received until a later year, while a deduction for a liability is to be accrued and taken when the liability becomes fixed and certain, even though it may not be paid until a later year."

See also *Central Trust Co. vs. Burnet* (CCA-DC), 45 Fed. 2d 992.

The record already shows that Appellee had been informed by the Insurance Commissioner and his Deputy that a reserve would have to be set up, in a certain

amount, in a certain year (during the year 1945) and that all of the title insurance companies in the State of Oregon would have to set up the same reserve (R. 27). The order was promulgated December 26, 1945 in the letter to the Title and Trust Company (Plaintiff's pre-trial Exhibit 2) and Appellee's officers were cognizant of this order and immediately proceeded to comply with it for the end of the year of 1945 (R. 28).

We wish to call the Court's attention to another feature of this case. Appellee attempted to file amended returns for the years 1942, 1943 and 1944 with the Internal Revenue Department claiming a portion of the amount of this reserve for each of these years. The Collector of Internal Revenue denied the Appellee the right to do this (Plaintiff's Exhibit 8).

CONCLUSION

The Appellee is an insurance company under the Insurance Code of the State of Oregon and is under the jurisdiction of the Insurance Commissioner of the State of Oregon and subject to all the insurance laws of the State of Oregon. The unearned premium reserve was properly set up by the rules and regulations of the State Insurance Department under the exercise of an appropriate power conferred by statute. In this case, the Insurance Commissioner of the State of Oregon, under the insurance laws, was given the power to promulgate the rule or order which was made and there was no unreasonable delegation of authority by the legislature. The rule was not arbitrary or capricious, but was based wholly upon complete examination and valuation of the circumstances. The reserve for unearned premiums as set up by the Appellee was given by the order promulgated by the Insurance Commissioner of the State of Oregon, the status ordinarily accorded an unearned premium in insurance law.

There is a time element as well as the element of contract to be considered in connection with the risk assumed in this type of insurance as well as in other types. There is no reason why it should not be treated as unearned premium within the meaning of the taxing statute during the period that it is reserved. The order of the Insurance Commissioner of Oregon has the effect of making it an unearned premium reserve. This is not a solvency reserve and it is not a permanent reserve, for at the end of 180 months a portion of the reserve fund

returns to the corporation surplus and thereafter each year a like portion of the reserve fund returns to the corporation to be used for general purposes and taxable as income. The reserve fund was properly set up by the Appellee in the year 1945 because it was in the year 1945 that the amount became fixed and determined. Also, at that time the funds were withdrawn from the control of the corporation and were placed in a trust fund for the benefit of the policyholders and the practical effect of this was to decrease by such amount the income of that year available for ordinary purposes.

We, therefore, submit to the Court that the decree of the District Court of the United States for the District of Oregon in favor of the Appellee was just and proper and should be affirmed.

Respectfully submitted,

Will H. Masters,
Wm. J. Masters,
Attorneys for Appellee.

APPENDIX

"SECTION 101-105, O.C.L.A., SUBDIVISION (1). The insurance commissioner shall have and exercise the power to enforce all the laws of the state relating to insurance, and it shall be his duty to enforce all the provisions of such laws for the public good. *He shall issue such department rulings, instructions and orders as he may deem necessary to secure the enforcement of the provisions of this act,* but nothing contained in this act shall be construed to prevent any company or persons affected by any order or action of the insurance commissioner from testing the validity of same in any court of competent jurisdiction."

"SECTION 101-105, O.C.L.A., SUBDIVISION (2). (Issuance of certificates, etc.) He shall issue all certificates and licenses under the seal of his office provided for by the terms of this act. Before granting certificates of authority to any insurance company to issue policies or make contracts of insurance in this state, the commissioner shall be satisfied by such examination as he may make, or such evidence as he may require, that such company is duly qualified under the laws of this state to transact business herein."

"SECTION 101-107, O.C.L.A., SUBDIVISION (7). CERTIFICATE OF AUTHORITY OF DOMESTIC COMPANIES. *A domestic insurance company shall be granted a certificate of authority* to transact any kind or class of insurance permitted by the provisions of the insurance laws of this state and provided for in its articles of incorporation upon its compliance with the laws of this state and the regulations of the insurance department relating to such companies and the payment of the fees and charges imposed by law, *which certificate may be*

revoked on thirty (30) days' notice by the insurance commissioner, or he may suspend same temporarily if he deems necessary or advisable. Cause for revocation or suspension of such certificate shall exist if its capital is found to be impaired or the required surplus has not been maintained or if *its transactions have been found to be in violation of the law.*"

"SECTION 101-136, O.C.L.A. (Examination into affairs of company or persons in insurance business: Appointment of examiners: Duty to produce books and papers and to facilitate examination: Report of examiners: Hearing: Inspection and publication of report: Expenses of examination.) *The insurance commissioner shall, whenever he deems it advisable in the interest of policyholders or for the public good, examine into the affairs of any insurance company,* agency, corporation, partnership, person or persons engaged in or proposing to engage in the insurance business in this state, and into the affairs of any company organized under any laws of this state or having an office or representative in this state, which company is engaged in or is claiming or advertising that it is engaged in organizing or receiving subscriptions for or disposing of stock of, or in any manner aiding or taking part in the formation or business of an insurance company or companies, or which is holding capital stock of one or more insurance companies for the purpose of controlling the management thereof as voting trustee or otherwise. For such purpose he may appoint as examiners one or more fair, impartial and competent persons, not officers of, nor connected with nor interested in any insurance company, other than as policyholders, nor in any other company above referred to, and upon such examination, he, his deputy or any examiner authorized by him may examine under oath the officers and agents of such company or agency and all persons deemed to have material information regarding the property or

business of such company or agency. Every such company or agency, its officers and agents, shall produce at the office of the company or agency where the same are kept its books and all papers in its or their possession relating to its business or affairs, and any other person may be required to produce any book or paper in his custody relevant to the examination, for the inspection of the insurance commissioner, his deputies or examiners whenever required; and the officers and agents of such company or agency shall facilitate such examination and aid the examiners in making the same so far as it is in their power to do so. Every such examiner shall make a full and true report of every examination made by him, verified by his oath, which shall comprise only facts appearing upon the books, papers, records or documents of such company or agency or ascertained from the testimony sworn to of its officers or agents or other persons examined under oath concerning its affairs, and said report so verified shall be presumptive evidence in any action or proceeding in the name of the people against the company or agency, its officers or agents, of the facts stated therein. The insurance commissioner shall grant a hearing to the company or agency examined before filing any such report and before making public such report or any matters relating thereto; and may withhold such report from public inspection for such time as he may deem proper; and if said company or agency offers no objection at said hearing, it will be an admission of acceptance; and may, after so filing, if he deems it for the interest of the public to do so, publish any such report of the result of any such examination as contained therein in one or more newspapers of the state without expense to the company or agency. Any company or association doing business in Oregon shall pay the just and legitimate expenses, including railroad fares and traveling expenses of any examination; and the commissioner shall revoke or

refuse his certificate of authority to any company neglecting or refusing to pay such expenses, or neglecting or refusing to furnish any information to said commissioner. It shall be the duty of the insurance commissioner to examine every domestic insurance company at least once in three years."

"SECTION 101-137, O.C.L.A. Examination: Reserve: Liability: (Formulating or adopting rules). In ascertaining the conditions of an insurance company under the provisions of this act, or in any examination made by the insurance commissioner, his deputy or examiner, he shall allow as assets only such investments, cash and accounts as are authorized by the laws of this state at the date of the examination, or under the laws of the state or country under which such company is organized and which investment he may approve or reject, but unpaid premiums on policies written within three months shall be admitted as available resources. *In ascertaining his liabilities,* unless otherwise provided in this act, *there shall be charged* the capital stock, all outstanding claims, *a sum equal to the total unearned premiums on the policies in force computed on a pro rata basis, and such an amount as may be found necessary as a reserve to provide for the future payment of deferred and undetermined claims for losses and promised benefits. In determining the amount of such reserve or unearned premium liability, the insurance commissioner, his deputy or examiner may formulate such rules as he may deem proper and consistent with law or he may adopt such rules as are used in other states or approved by the national convention* of insurance commissioners."

In the case of *Early vs. Lawyers Title Ins. Corp.,* 132 Fed. 2d 42, Mr. Justice Parker speaking for the Court, held:

"The contention of the appellant is that premiums paid for title insurance are earned when received, that there is no basis for treating any part of such premiums as unearned and that the effect of the statute of Virginia is to provide a mere solvency reserve which the company is not entitled to treat as unearned premiums. Appellant is undoubtedly correct in the position that ordinarily a premium paid for title insurance is to be treated as fully earned when received. *American Title Co. v. Commissioner of Internal Revenue,* 3 Cir., 76 Fed. 2d 332; Huebner on Property Insurance, p. 493. And in the absence of the Virginia statute replied on by the company we should feel constrained to hold that no part of the premiums received for title insurance could be treated as 'unearned' within the meaning of the section of the Revenue Act above quoted.

"As said by the Circuit Court of Appeals of the 5th Circuit in *Commissioner of Internal Revenue v. Dallas Title & Guaranty Co.,* 119 Fed. 2d 211, 213, however, 'it is not impossible for premiums paid a title insurance company to be unearned'. Unquestionably the premium collected for title insurance is not all clear profit or income to the company immediately upon its receipt. As a matter of fact, there is a time element as well as the element of contract to be considered in connection with the risk assumed in this type of insurance as well as in other types; and if any portion of the premiums, in consideration of the time element, is given, either by law or contract, the status ordinarily accorded an unearned premium in insurance law during any portion of the period for which the risk is operative, there is no reason why it should not be treated as an 'unearned' premium within the meaning of the taxing statute during this period. We think that the Virginia statute has this effect.

"The liability under a title insurance policy, which in the case of this company is shown under

the law of averages to be around 6% of the premiums collected, is outstanding as a continuing liability of the company to the policyholders; and, in recognition of this fact, the Virginia statute requires that a certain portion of the premiums, 10%, be set aside and held intact for a period of time for the discharge of this liability. The sums thus set aside 'at all times and for all purposes' are, by mandate of the statute, to 'constitute unearned portions of the original premiums'. This means that they are not available to the company for its ordinary purposes, until the times limited in the statute have expired, but, until then, are held in trust for the benefit of the contract holders. If the company should in the meantime become insolvent, they would be available as unearned premiums for reinsurance of the contracts, or if not used for that purpose would belong to the contract holders. *Johnson v. Button,* 120 Va. 339, 91 S.E. 151, 153; *Lovell v. St. Louis Mutual Life Ins. Co.,* 111 U.S. 264, 274; 4 S. Ct. 39, 23 L. Ed. 423; 32 C.J. p. 1040.

"There is no reason why the legislature may not thus require the company to deal with a portion of the premiums collected, just as, in the absence of contract between the parties, it may provide how the policy is to be valued for the purpose of setting up a reserve. Cf. 32 C. J. 1017; *Elder v. Bankers' Life Ins. Co.,* 117 App. Div. 722, 102 N.Y.S. 702. If the statute had provided that 10% of the premiums collected should be held for the benefit of policyholders for a fixed period and should belong to the company only after it had carried the liability for that period, it would hardly be contended that this portion of the premiums was earned within the meaning of the Revenue Act until the expiration of the period; but this is precisely the effect of the Virginia statute in providing that the sums required to be placed in reserve 'shall at all times and for all purposes be considered and constitute unearned portions of the original premiums'.

"Very much in point is the decision of the Circuit Court of Appeals of the First Circuit in *Massachusetts Protective Ass'n. v. United States,* 1 Cir., 114 F. 2d 304, 213. That case involved the right to deduct as unearned premiums a reserve required by law to be kept by an accident and health insurance company. In that case, as in this, there was no provision for cancellation or for return of any part of the premium to the insured. In upholding the right to deduct this reserve as unearned premiums, notwithstanding that there was no requirement that anything be returned to the policyholder, the court said:

" 'Congress is only interested in determining what part of a company's gross income should be treated as net income for the purposes of taxation. *McCoach v. Insurance Co. of North America,* 1917, 244 U.S. 585, 37 S. Ct. 709, 61 L. Ed. 1333. In general, premium income is not such, and its inclusion in gross income is only justified by the deductions allowed. See Hearings before the Committee on Ways and Means on the Revenue Act of 1918, 65th Cong., 2nd Sess., Pt. 1 (1918) 811. The additional reserve for non-cancellable health and accident policies, whether returnable to the insured or not, is not available for the use of the general purposes of the plaintiff. It is held as a liability to provide for the payment or reinsurance of specific contingent insurance liabilities proven by experience to be a part of the cost of this particular type of insurance in the future years. * * * As long as these reserve funds must be held to provide for expected insurance liabilities in the future on these non-cancellable health and accident policies and are not to be used for the general purposes of the company, they are not "earned premiums" within the meaning of Congress and not includible in gross income. The test is not whether the part of the premium set aside in the reserve for non-cancellable health and accident insurance "belongs" to the company in the event of cancellation or lapsing of the policy, but

whether that amount is such a part of the company's gross income as Congress considered should be treated as net income for the purposes of taxation. *McCoach v. Insurance Co. of North America, supra*. We hold that it is not.' "

"We were disturbed upon the argument because the deduction of the reserve resulted in what seemed to be a distortion of the income of the company for the year 1936. Further consideration convinces us that the position of the company with respect thereto is correct. Under the language of the Revenue Act there is no authority for adding to premiums received during 1936 any part of the reserve held at the end of the preceding year, as none of this reserve had been given the status of unearned premiums. The passage of the Virginia statute unquestionably resulted in funds to the amount of the reserve at the end of the year being withdrawn from the unfettered control of the company and being held in trust for the benefit of contract holders; and the practical effect of this was to decrease by such amount the income of the year available for ordinary purposes. Furthermore, income tax had already been paid on the amount held in reserve prior to the passage of the statute; and, to add any part of this amount to the premiums collected in the year 1936, for the purpose of determining underwriting income for that year, would result in its being taxed twice. The amount deducted as unearned premiums does not, of course, escape taxation, since it is subjected to tax as it is released from the reserve pursuant to the provisions of the statute."